Federal Communications Commission
Washington, D.C.

CHAIRMAN

November 18, 2004

The Honorable Joe Barton
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Barton:

In response to your May 18, 2004 request, I am pleased to provide the Committee on Energy and Commerce the enclosed Report concerning the packaging and sale of video programming services by cable and satellite television providers. The Report was prepared by the Commission's Media Bureau.

To assist in the preparation of the Report, the Bureau issued a *Public Notice* seeking public comment and information on the technical, economic and legal issues identified in your request. The Bureau also conducted a symposium last summer to explore first-hand the advantages and disadvantages of an *a la carte* marketing scheme, including its potential implications for the prevalent economic model in the pay television industry, as well as its possible effects on retail prices and new entrants in the video programming market. The specific questions outlined in your letter are addressed in Appendix F to the Report.

If you or other Committee members have any questions concerning the Media Bureau's Report, please do not hesitate to contact me.

Sincerely,

Michael K. Powell

Enclosure

Report
On the Packaging and Sale of
Video Programming Services
To the Public

November 18, 2004

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I. INTRODUCTION AND SUMMARY

Earlier this year, several members of the U.S House of Representatives' Committee on Energy and Commerce wrote to Federal Communications Commission Chairman Michael Powell asking for Commission insight on the "efficacy of providing a la carte and themed-tier services to cable and satellite subscribers."[1] Separately, Senator John McCain, Chairman of the United States Senate, Committee on Commerce, Science, and Transportation, asked Chairman Powell to "explore all available options . . . to promote a la carte and satellite offerings as soon as possible where such offerings would benefit consumers."[2]

At the heart of these Congressional requests for the Commission to study a la carte and themed-tier services for cable and satellite subscribers is our nation's long-standing public policy goal of making available communications and media technologies to all Americans at affordable rates. Although it is undeniable that the last decade has brought the public a wealth of new benefits and value stemming both from the introduction and continued growth of direct broadcast satellite systems ("DBS" or "satellite carriers") as strong, nationwide competitors to cable in the multichannel video programming distributor ("MVPD") marketplace, and the cable industry's collective $85 billion investment to upgrade its distribution platform and product offerings, it is equally undeniable that many Americans are frustrated with year over year increases in their pay-television bills. In a desire to empower consumers and to bring them more choice, and in hopes of stemming the tide of rising MVPD retail rates, some have turned to a la carte and themed-tier services as a potential solution.

Others believe that a la carte and themed-tier services may serve as an effective means for the public to address another issue of concern to millions of Americans—the growing coarseness of programming on television. As the explosion of channel capacity and new program networks have brought some of history's best television to living rooms across the country—from educational and children's programming to news, public affairs and sports programming—it also has provided a significant amount of coarse programming. Many view a la carte and/or themed-tier services (such as a packaged tier of family programming) as a way to give adults, especially parents of young children, an ability to prevent objectionable programming from entering their homes or to more easily find family-friendly programming.

A third, albeit less pronounced, catalyst behind the interest in exploring the feasibility and impact on the public of a la carte or themed-tier services is the impact of the tying of cable/satellite program networks to the carriage of large broadcast network affiliates through retransmission consent. Some argue that the use of retransmission consent by some of our nation's largest broadcast networks has hindered the development of independent program networks, threatening diversity, and view a la carte and theme-tier services as a potential vehicle to limit these perceived effects of retransmission consent.

These core communications policy goals—consumer choice, universal and affordable access to communications and media technologies, diversity and parental control over the media that enter their

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[1] The House members asked the Commission to address questions in seven general areas and submit a Report to the Committee by November 18, 2004. Letter from the Hons. Joe Barton, John D. Dingell, Fred Upton, Edward Markey, and Nathan Deal, U.S. House of Representatives, to the Hon. Michael K. Powell, Chairman, Federal Communications Commission, May 18, 2004. ("House Letter") The letter is attached as part of Appendix A. A concise issue-response summary to the House Letter is found in Appendix F.

[2] Letter from the Hon. John McCain, Chairman, United States Senate, Committee on Commerce, Science, and Transportation, to the Hon. Michael K. Powell, Chairman, Federal Communications Commission, May 19, 2004. ("McCain Letter") The Letter is attached as part of Appendix A.

homes—have been guideposts for Congress and the Commission since the advent of broadcast radio and throughout the development and growth of broadcast television, cable television, DBS and other electronic mass media platforms. These goals are shared by those who advocate an a la carte or themed-tier services regime for cable and satellite subscribers.

During these early stages of the a la carte discussion in Congress, however, many raised concerns of whether an a la carte or themed-tier services regime would be the most effective means of achieving our shared policy objectives. Others went further to suggest that a government mandated a la carte or themed-tier services regime would only thwart some of these policy goals by increasing retail rates for the vast majority of cable and satellite subscribers and not enhancing, but diminishing (and in several cases, eliminating) the progress made by new, niche program networks and their contribution to diversity on television.

It is with these goals, worries, and questions in mind that several Members of Congress asked the Commission to study the facts and economics of a la carte or themed-tier services on cable and satellite subscribers. This Report is the result of that inquiry. Although this Report should not be viewed as providing definitive answers to all of the questions surrounding the impact of a la carte, themed-tier services or retransmission consent on the public, it should serve as a useful starting point for discussion as Congress, the Commission, the public interest community, and the industry continue to strive to bring the public the benefits of the most diverse and competitive media marketplace in the world.

In response to the Congressional inquiries, the Media Bureau ("Bureau") issued a Public Notice ("*PN*" or "*A La Carte PN*") requesting comment on factual and legal questions regarding the provision of a la carte and themed-tier services on cable television and DBS.[3] The Bureau also sponsored a

[3] *See* Public Notice, *Comment Requested on A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems,* 19 FCC Rcd 9291 (MB, May 25, 2004). The Public Notice is attached in Appendix B. In the past two years, a la carte pricing for MVPD service has received considerable attention from Congress, the Commission, and other government agencies. For example, On March 25, 2004, the Senate Committee on Commerce, Science, and Transportation, held a hearing entitled, "Escalating Cable Rates: Causes and Solutions" and on July 14, 2004, the House of Representatives Committee on Energy and Commerce and Subcommittee on Telecommunications and the Internet held a hearing entitled, "Competition and Consumer Choice in the MVPD Marketplace—Including an Examination of Proposals to Expand Consumer Choice, Such as A La Carte and Themed-Based Tiers." *See also* General Accounting Office, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO-04-8, Report to the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate (October 24, 2003) at 5-6, 30-39 (finding that, while an a la carte system might provide greater consumer choice, it would impose additional costs on subscribers and alter the current economic structure of the cable industry). The Commission has also sought information and received comment regarding the packaging and marketing of programming services. *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 19 FCC Rcd 1606, 1705-06 (2004) ("2003 Video Competition Report" or "2003 Report") (finding that bundling program networks into packages allows greater penetration of individual channels, which lowers the per subscriber price MVPDs pay to programmers, and creates subscriber awareness of new networks). *See also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Notice of Inquiry, 19 FCC Rcd 10909, 10915 (2004) ("2004 NOI").

symposium to further examine a la carte and themed-tier proposals.[4] The Bureau received nearly 400 comments, reply comments, *ex parte* communications, testimony, and letters in this proceeding.[5]

This Report provides an overview of the law and economic theories relevant to the discussion concerning a la carte. The Report summarizes the comments and analysis submitted by interested parties in this proceeding. It also incorporates, by reference, statements made by expert witnesses at the a la carte symposium sponsored by the Media Bureau.

First, the Report discusses the retail market for video programming by MVPDs, primarily, cable operators and DBS providers. This section provides a historical overview of cable's delivery of programming services to the public and the current programming options available to consumers, including premium networks and other a la carte offerings, over cable and satellite. In addition, this section discusses current retail regulatory requirements, including tier placement and tier buy through requirements.

This section then analyzes current cable and satellite retail programming packaging practices with a focus on the harms and benefits to the public of bundling programming at the retail level. Included in the discussion of potential harms associated with bundling is the fact that under the current bundling regime, cable prices have increased by an average of 4.6 % per year and in excess of 7 % per year for the expanded basic program tier over the past five years. Some commenters allege that as cable rates have increased at nearly three times the rate of inflation, the industry's practice of making most networks available as part of a bundle or tier has contributed to the rise in retail rates. In addition, some commenters suggest that the industry's current bundling practices effectively limit consumer choice and force upon them channels that they do not watch or wish to receive, including objectionable content.

The record reflects that along with harms, bundling also produces several benefits for cable and satellite households. For example, commenters suggest that the bundling of distinct program networks lowers transaction costs, helps programmers reach economies of scale and enhances the attractiveness or convenience of the product to consumers. Indeed, the Report discusses how tiering allows a video programmer to recover a large percentage of its costs from consumers that value its programming highly and a smaller percentage from consumers that value its programming less highly. In this way, consumers of different program networks are able to, in a sense, cross-subsidize each others' viewing habits, allowing new and diverse programming to survive in the marketplace. Additionally, bundling may actually enhance consumer sovereignty by creating a mechanism for consumers to have access to a wide variety of viewing choices serving many diverse, niche viewer interests.

Next, this section discusses the feasibility of a la carte and themed tiers, including the alleged harms and benefits of such a regime, the steps the industry would need to take to implement it, the likely consequences for the public, and historical experiences with a la carte. Proponents of a la carte or themed-tier services suggest these retail programming options (in addition to offerings in existing tiers) would provide consumers with additional choice and act as a strong check on cable rate increases. They suggest that consumer response to individual channel prices would instill competitive discipline among

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[4] *See* Public Notice, *Media Bureau Announces Speakers for Symposium on "a la carte" MVPD Pricing*, 2004 WL 1562950, (MB July 13, 2004). The Public Notice is also attached in Appendix B. The Bureau received testimony addressing the feasibility of a la carte as well as the economics of bundling and tiering. Testimony was incorporated into the record of this proceeding.

[5] Several large and small cable operators, DBS providers, and dozens of program networks filed lengthy comments. *See* Appendix C for a list of commenters. Some pleadings were filed jointly by several groups, and the individual participants in those groups are listed in Appendix C.

program networks and restrain excessive growth in programming costs. Still others argue that a la carte would provide a solution to the growing public concern about violent and objectionable programming.

Despite these benefits, the majority of commenters contend that a la carte or themed-tier services would impose significant costs on consumers. For starters, these commenters state that consumers would need to pay more than they do today for far fewer channels, unless they selected a small number of channels, far below the national average of channels currently watched by MVPD households. Most program networks suggest that the number, quality and diversity of program networks would all be severely diminished under an a la carte regime. Furthermore, commenters state that there are significant structural impediments, most notably for cable operators, who would be forced to offer a la carte by using traps and hybrid set-top boxes, simulcasting all basic and expanded basic channels in analog and digital format, or spending billions of dollars to convert systems to all-digital distribution. Finally, commenters cite operational impediments (including marketing, billing and other operational expenses that would drive up retail rates), conceptual impediments (consumer confusion and difficulty of determining which networks qualify for any particular programming tier) and legal impediments (raising First and Fifth Amendment issues) to an a la carte or themed-tier mandate.

Although the Commission shares the public's concern about rising MVPD rates and the growing coarseness of programming on television and strongly believes in providing the public with greater choice in how they consume television, the Report finds that many of the harms suggested by opponents of a la carte or themed-tier services have merit, although not necessarily to the degree advocated by its most vocal critics. The Report concludes that a la carte regulation will likely increase operational expenses for MVPDs in three main areas: (1) equipment and infrastructure; (2) customer service operations; and (3) billing and back office support. Unless constrained by regulation, many of these increased costs would likely be passed on to subscribers, resulting in higher subscriber fees. In addition, the MVPD cost increases would be most detrimental to smaller cable operators, who often have more limited and more costly options when it comes to obtaining capital to support investment in their operations. The Report discusses how this would have an adverse impact on competition as smaller cable operators would have a difficult time competing with the industry's primary competitors—the DBS providers.

The Report also finds legitimacy to programmers' concerns about an a la carte regime. Existing networks sold on an a la carte basis spend a significant amount of their revenue marketing themselves to consumers. Under an a la carte mandate, networks formerly sold in tiers would need to significantly increase their marketing expenses to induce consumers to affirmatively select the network. Moreover, any type of a la carte requirement would have a significant negative effect on a program network's advertising revenues and license fee structure. The loss of cost savings, combined with the loss in advertising revenue and the likely rise in license fees to compensate such losses, may cause many program networks to fail, thus adversely affecting diversity. The most likely to feel the brunt of such a mandate would be networks serving small niche interests, such as religious programming, programming aimed at minority interests, arts programming and independently owned networks. The impact on program networks seems likely under either a mandatory or voluntary a la carte regime.

Moreover, it is unclear that an a la carte regime would produce the desired result of lower MVPD prices for many pay-television households. The Report's economic analysis estimates that the impact on retail rates of pure or mandatory a la carte sales indicates that only those consumers who would purchase fewer than 9 program networks may see a reduction in their monthly cable bill. Consumers that purchase at least 9 networks would likely face an increase in their monthly bills. The average cable household watches approximately 17 channels, including broadcast stations. If the average household purchased each of these channels under an a la carte regime, it would likely face an increase in their monthly bill under a la carte sales of between 14% and 30%.

The Report also describes some new a la carte models that may help mitigate some of the harms associated with a pure a la carte or themed-tier services, including "mixed bundling" or voluntary a la carte where cable operators and satellite carriers offer programming on tiers and individual channels on an a la carte basis. Although the impact of such a regime is less clear than a pure a la carte system, many of the increased operational expenses discussed in the Report would apply to either pure or voluntary a la carte.

Recognizing the need to pursue our traditional public interest policy goals of enhancing consumer choice, fostering MVPD competition and programming diversity, and providing our citizens with the tools to prevent objectionable programming from entering their homes, the Report discusses several policy recommendations for the retail MVPD market that the Congress and Commission should pursue irrespective of whether or not Congress pursues a la carte or themed-tier services legislation. First, the success of DBS as a competitor to cable suggests that policymakers should provide incentives for more MVPD competition in the marketplace. Marketplace forces and technological advances are poised to bring more competition and choices to the public. For example, two separate entities plan to use over-the-air broadcast spectrum to provide subscribers with a low-cost alternative to cable and DBS. One of those entities, USDTV is already competing in three markets. In addition, recent announcements suggest that several telephone companies are planning large scale entry into the residential video programming market. These entrants may not only drive price and innovation competition, but they also may force upon the industry the need to create new programming models, including new, specialized tiers that would bring much of the choice sought by a la carte advocates.

Second, policymakers should provide incentives for operators to offer more control over programming choices to the public. Here, too, technological advances are already putting the power over programming in the hands of consumers. The continued roll-out of video-on-demand ("VOD") and digital video recorders ("DVRs") is presenting the public with more control over what they watch and when they watch than at any time in history.

Third, policymakers should continue to pursue aggressive policies to provide incentives for broadband deployment. Video over internet protocol is in its infancy, yet is bringing a la carte choices over the Internet to many Americans. Programmers such as Major League Baseball, who offers individual baseball games on an a la carte basis, are showing the potential of using the Internet and its lower distribution costs to make a la carte a reality. Fourth, policymakers should continue to encourage blocking technologies and consumer awareness of these technologies over cable and satellite to ensure that the public can block any unwanted programming from entering their homes.

The Report also addresses concerns about the acquisition of programming by MVPDs at the wholesale level. In negotiations for programming, including broadcast programming that must be obtained through retransmission consent negotiations, the acquisition of rights to an attractive popular program network is sometimes contractually tied to the purchase and carriage of a less attractive or less desired network. The Report concludes that the manner in which this takes place raises questions as to whether the carriage of less popular programming is in the public interest because it takes away channel capacity that MVPDs could devote to other, better uses. The Report suggests, however, that if this practice is anti-competitive and it is causing consumer harm (both of which are currently far from clear and would benefit from further study), the antitrust authorities are best positioned to remedy the situation.

II. THE RETAIL MARKET FOR VIDEO PROGRAMMING

A. Background

This section discusses how cable operators and other multichannel video programming distributors distribute and sell programming to consumers. Cable operators deliver MVPD services to millions of U.S. households. Ten years ago, cable operators served almost 100% of the nation's MVPD subscribers. Today, cable's share has fallen to approximately 75% of all MVPD subscribers. DBS, cable's main competitor, has grown rapidly in the last five years and now serves the second largest share of MVPD subscribers.[6]

The *PN* asked whether cable operators and DBS may purchase program networks on a stand-alone basis and offer programming to their subscribers on an a la carte or themed-tier basis. The *PN* inquired whether there are any limitations on their flexibility to do so and whether MVPDs can currently offer a la carte and themed-tier service in addition to the packages currently offered to subscribers.[7] The questions raised in the *PN* are, in part, directed at the practice of "tiering." Tiering involves the bundling (packaging) and sale of channels of programming for separate or incremental charges.[8] Cable systems and virtually all other MVPDs offer video programming services in tiers. Tiering permits subscribers to easily choose a bundle of video programming services at different price points.

B. Historical Overview

More than half a century ago, cable television was a simple technology for retransmitting local and distant broadcast stations to areas unserved or underserved by over-the-air signals.[9] Cable systems, generally, were equipped to provide no more than 12 channels of programming, which were transmitted by coaxial cable on the same 12 VHF frequencies used by over-the-air broadcast stations. Subscribers simply attached the cable to their sets in lieu of an over-the-air antenna and tuned to the 12 channels on their television sets to receive all the signals being delivered by the cable system. Even in those days before the advent of satellite-delivered cable programming, cable operators began offering premium movie and sports programming on an optional per-channel charge basis.

To accommodate new satellite-delivered programming services, such as HBO, that began to appear in 1975 and thereafter, cable operators upgraded the channel capacity of their systems. While most of the cable program networks added to cable systems during this period of expansion were included in the basic service tier or expanded basic tier,[10] a number of new networks were launched as a la carte,

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[6] Currently, four operators hold licenses to provide DBS service: EchoStar (marketed as the DISH Network), DirecTV, Dominion Video Satellite, Inc. (marketed as Sky Angel), and Cablevision's Rainbow DBS (marketed as Voom).

[7] *PN*, 19 FCC Rcd at 9291-92.

[8] The Act does not specifically define the term "tiering" but the phrase, "service tier," is defined "as a category of cable service or other services provided by a cable operator and for which a separate rate is charged by the cable operator." *See* 47 U.S.C. § 522(17).

[9] At that time, cable was known as Community Antenna Television Systems ("CATV").

[10] In this Report, the term, "Expanded Basic Tier," is used to describe that tier of cable service above the basic service tier. The expanded basic tier is sometimes referred to as the cable programming service tier or "CPST."

premium channels. Some of these premium channels primarily showed uncut, recently released movies and others offered regional sports programming. Most of these premium channels, such as Encore and Bravo, carried no commercials and were offered to consumers for approximately ten dollars per month.[11]

In 1984, Title VI of the Communications Act was added by the Cable Communications Policy Act of 1984 ("1984 Act").[12] The 1984 Act was largely "de-regulatory" legislation, whose purposes were to, *inter alia*: (1) establish a national policy concerning cable communications, (2) assure that cable communications provide diverse programming to the public; and (3) promote competition in cable communications while minimizing "unnecessary regulation." By establishing a clear regulatory framework, the 1984 Act provided an impetus for the cable industry's continued growth throughout the 1980s.[13] In the period between the 1984 Cable Act and 1992, the cable industry grew larger and began to exert its market power as the dominant provider of multichannel video service.[14] In 1992, Congress enacted the Cable Television Consumer Protection and Competition Act ("1992 Cable Act").[15] This Act substantially re-regulated the cable industry and contained a host of requirements affecting nearly every facet of the cable business. Mandatory access for broadcasters (must carry and retransmission consent provisions) were codified, pricing and marketing restrictions (rate regulation, basic service tier, and customer service obligations) were imposed, ownership limits (both horizontal and vertical restrictions) were established, and program carriage, program access, and other requirements were included in the Act.

The core of Section 623 of the Act, as amended by the 1992 Cable Act, is dedicated to cable television rate regulation.[16] In 1993, the Commission issued its *First Rate Report and Order* setting forth

[11] NCTA Comments at 19.

[12] Cable Communications Policy Act of 1984, Pub. Law 98-549, 98 Stat. 2779 (1984).

[13] At about the same time the Commission began implementing the 1984 Act, the United States Court of Appeals struck down the Commission's existing must carry requirements for cable operators on First Amendment grounds. *See Quincy Cable TV, Inc. v. FCC*, 786 F.2d 1434 (D.C. Cir. 1985) (striking down the first Commission set of must carry rules); *Century Communications Corp. v. FCC*, 835 F.2d 292 (D.C. Cir. 1987) (striking down the Commission's second attempt at establishing must carry rules). For a period of about five years, the cable industry had no mandatory obligation to carry local broadcast stations, although most cable systems continued to carry stations on a voluntary basis.

[14] *See* 47 U.S.C. § 521 nt (a).

[15] Cable Television Consumer Protection and Competition Act of 1992, Pub. Law 102-385, 106 Stat. 1460 (1992).

[16] 47 U.S.C. § 543(b) and (c). Basic service tiers rates are regulated, in the absence of effective competition, by local franchising authorities ("LFAs"). Expanded basic rates were, at one time, regulated by the Commission. Cable systems demonstrating that they face effective competition, under one of the statutory tests, are not regulated under Section 623. *See* 47 U.S.C. § 543(l)(1); 47 C.F.R. § 76.905.

methodologies for cable operators to calculate rates at regulated levels.[17] The Commission additionally held, in accordance with the relevant statutory provisions, that channels offered on an a la carte basis would not be rate regulated if certain conditions were met.[18] In 1994, the Commission, *inter alia*, imposed a 7.5 percent cap on the permissible mark-up of costs for adding new program services.[19] In that same year, the Bureau also issued a series of rulings and waivers to facilitate new program service launches.

According to some in the cable industry, the Commission's rate regulations had a number of unintended consequences. First, it reduced investment in cable system upgrades and had a particularly harsh impact on small operators. Second, it reduced incentives for cable operators to add new program services and, consequently, led to a reduction in program diversity. Finally, it reduced programming quality and led to unique hardships for programming targeted to specific groups, such as minorities.[20] The Commission recognized these disincentives and adopted the "going forward" rules in late 1994, to encourage the carriage of new program services.[21] As an alternative to the 7.5 percent cap, the rules allowed cable operators to add new channels to the expanded basic tier at a price of not more than $.20 per channel plus license fees (with a total increase over two years not to exceed $1.50). The Commission also created a new type of program package, called the New Product Tier ("NPT"). Cable operators were permitted to offer NPTs on an unregulated basis. In the *Going Forward Order*, the Commission also reversed its previous decision that channels sold on an a la carte basis would be unregulated, and instead held that a collection of program networks sold a la carte were to be regulated as cable programming service tiers.[22]

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[17] *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 8 FCC Rcd 5631, 5644 (1993) ("*First Rate Report and Order*"). The rate rules, when adopted, were primarily based on a benchmark and price cap approach to setting rates for regulated cable service whereby existing rates for cable service were compared to a benchmark that reflected the rates charged by cable systems subject to effective competition. Once initial rates were determined, rates were governed on a going-forward basis by a price cap mechanism that permitted periodic adjustments for inflation, changes in the number of regulated channels, and changes in external costs, including programming costs, franchise requirements, state and local taxes on cable service, and franchise fees. In addition to the benchmark approach, the Commission provided a cost of service option for cable operators unable to recover costs after calculating a maximum rate based on the benchmark process.

[18] *First Rate Report and Order,* 8 FCC Rcd at 5836. The Commission held that collective offerings of a la carte channels would not be regulated if: (1) the price for the combined package did not exceed the sum of the individual charges for each component service and (2) the cable operator continued to provide the component parts of the package to subscriber separately in addition to the collective offering. *Id.* at 5836-37. In support of its policy, the Commission stated that Congress excluded per channel or per program premium services from rate regulation on the basis of a determination that "greater unbundling of offerings leads to more subscriber choice and greater competition among program services." The Commission applied the same rationale to non-premium channels. *Id.* at 5836, n.803. The Commission later set out 15 interpretive guidelines to enable cable operators to better determine what collective offerings of a la carte channels would be considered "realistic service offerings." *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 9 FCC Rcd 4119, 4213-16 (1994).

[19] *Id.*, 9 FCC Rcd at 4166, 4242.

[20] *See* Comcast Comments at 12; A&E Comments at 28.

[21] *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 10 FCC Rcd 1226, 1232, 1248 (1994) ("*Going Forward Order*").

[22] *Id.* at 1241-44.

Section 623 of the 1992 Cable Act also required the Commission to adopt standards and guidelines to prevent evasions, "including evasions that result from retiering."[23] In the *First Rate Order*, the Commission defined evasion as "any practice or action which avoids the rate regulation provisions of the Cable Act or Commission rules contrary to the intent of the Act or its underlying policies.[24] In 1994, the Bureau released several decisions, exonerating many cable operators who offered a la carte channels of evasion charges, due not only to the small number of channels offered on such a basis, but also because of the uncertainty created by the constant changes in the Commission's rate policy and rules at that time. Even though the Bureau found there were no rate evasions by these operators, it nonetheless suggested that a take-rate of a la carte program networks by subscribers of less that 2 percent proved that they were not "realistic service offerings" for the purposes of the retiering/evasion analysis.[25]

After years of regulation resulting from the 1992 Cable Act, Congress enacted the Telecommunications Act of 1996 ("1996 Act").[26] As part of the 1996 Act, Congress repealed the authority of the Commission to regulate cable programming service tier rates after March 31, 1999.[27] The price deregulation measures, and other generally deregulatory provisions affecting other parts of the Act, are credited with increasing investment in the cable industry. As a result, cable operators embarked on major rebuilds of their cable systems to increase channel capacity.[28] The result has been a substantial increase in the number of program networks and tiers, as well as the emergence of new digital technologies.

Comcast and Charter frame this period of government action in the following way. For four years, the government enacted a complex statutory regulation scheme, adopted implementing regulations, adopted new regulations to overcome the unintended consequences of the first regulations, and then eliminated the regulations in their entirety. The Commission issued over 20 separate rate orders and hundreds of regulations, fact sheets, notices of inquiry, and notices of proposed rulemaking. And the results of these efforts were: (1) severe cutbacks in programming and infrastructure investment; (2) reduced program diversity; (3) a nearly decade-long delay in the digital transition; and (4) no improvement in consumer welfare. Comcast argues that the government should not "go down that road again" with a la carte or any other restrictions on packaging or pricing.[29] Charter submits that a federally-

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[23] 47 U.S.C. § 543(d).

[24] *First Rate Report and Order*, 8 FCC Rcd at 5915.

[25] *See, e.g., Comcast Cablevision City of Tallahassee, Florida, Letter of Inquiry*, 9 FCC Rcd 7773 (1994) (offering a few channels on an a la carte basis not an evasion given the totality of the circumstances), *aff'd*, 11 FCC Rcd 1246 (1995).

[26] Pub. L. No. 104-104, § 301(b), 110 Stat. 56, 115 (1996).

[27] 47 U.S.C. § 543(c)(4). The Commission implemented Congress' directives in later rulemakings. *See generally Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 5296 (1999). The Commission is conducting a review of its current rate requirements in an effort to harmonize and modernize the rules in light of the sunset of CPST regulation. *See Revisions to Cable Television Rate Regulations*, 17 FCC Rcd 11550 (2002), *revised*, 17 FCC Rcd 15974 (2002).

[28] Since 1996, the cable industry states it has invested over $85 billion in system upgrades -- roughly $1,200 for every cable customer -- and over $69 billion in programming. National Cable & Telecommunications Association, *2004 Mid Year Industry Overview* 3, 12 (2004), *available at* http://www.ncta.com/pdf_files/Overview.pdf.

[29] Comcast Comments at 15.

mandated a la carte regime today would be even more detrimental to the cable industry's ongoing operations than the experience with cable rate regulation in the 1990s.[30]

Consumers Union and Consumer Federation of America ("CU/CFA" or "CU") believes that an a la carte requirement is not akin to rate regulation and, in any event, will discipline rates more effectively than past government attempts to do so. CU asserts that the 1992 Cable Act gave regulators "a weak set of tools and the rules were badly crafted." CU states that a la carte "rests on a much more powerful force, consumer sovereignty in the marketplace." CU suggests that a la carte offers consumers more control, choice, and freedom.[31]

C. Current Cable Services and Program Options

Analog to Digital. Since their inception over 50 years ago, cable systems have carried programming in an analog format. Cable operators continue to distribute programming in this format because virtually all television sets in U.S. households are analog.[32] Cable operators generally allocate two-thirds of their systems' channel capacity to transmit 80 channels of analog programming on analog tiers of service. The other one-third of channel capacity is used for digital services, including more channels of video programming. Cable operators control access to services in the analog tier through addressable or non-addressable technologies and control access to digital programming on the digital tier by using digital set top boxes. Older analog systems that have not been upgraded to digital technology, generally use passive traps (frequency selective filters),[33] non-addressable set top boxes (descramblers), or analog addressable set top boxes, to block out signals. Analog subscribers in systems which use traps do not need set top boxes. Newer cable systems have the capability to communicate electronically from their headends to those subscribers who have addressable analog or digital set-top boxes. Many cable systems employ a hybrid of addressable and non-addressable technologies to control subscribers' access to different tiers of cable services.

Basic and expanded basic services offered by cable operators typically consist entirely of analog channels offered in the clear. This allows the entire package to be received by any subscriber with a cable-ready set without installing a set-top box. Because expanded basic channels are typically offered in

[30] Charter Comments at 2-3.

[31] CU\CFA Reply Comments at 32-33.

[32] Analog video signals transmit video information using analog waveforms. In North America, the National Television Systems Committee ("NTSC") signals are an example. The NTSC signal primarily contains synchronization, picture, and sound information in channels spaced 6 MHz apart. There are different digital formats currently used by the electronic media. For example, broadcast stations use vestigial sideband ("VSB") while cable systems use quadrature amplitude modulation ("QAM").

[33] A trap is an inexpensive filter, generally located in or near a subscriber's home, designed to remove one or more signals (frequencies) and is used to control the delivery of cable services. The cable industry has generally employed three kinds of traps: positive traps, negative traps, and band pass or band stop filters. Positive traps are designed to remove interfering (scrambling) signals inserted at the cable headend that secure the channel. Installing a positive trap enables the subscriber to view the channel. In systems that do not scramble their signals, negative traps are used to remove the actual signals of one or more television channels. Removing the negative trap--or not installing it--enables the subscriber to view the channel. Band pass or band stop filters are designed either to pass or block a specific band of frequencies (signals), thus controlling the delivery of an entire block of video channels to the subscriber. Traps can have a degrading effect on signal quality, limiting their use. *See Cable Television Technical and Operational Requirements/Review of the Technical and Operational Requirements of Part 76,* 7 FCC Rcd 2021, 2027 (1992), *clarified,* 7 FCC Rcd 8676, 8681 (1992).

a contiguous frequency block, they can be secured from delivery to basic-only subscribers using a band stop filter. Existing technology does not allow each individual channel on the expanded basic tier to be offered on an a la carte basis.

Several cable operators began to provide digital tiers, in addition to existing analog tiers, over their cable systems starting in 1997. Today, all major cable operators offer digitally-compressed video channels to cable subscribers on digital tiers. The digital cable services may be viewed on analog television receivers through use of a digital cable set-top box. Digital compression technologies allow anywhere from four to 12 video channels to be compressed into the capacity previously used to provide just one standard six MHz analog channel.[34] The programming available on digital tiers includes a variety of genres, such as sports, movies, children's, and foreign-language programming. At the end of June 2003, digital cable service was available to approximately 90 percent of all cable subscribers and the number of subscribers to digital video service grew to 20.6 million.[35]

The migration to digital transmission has enabled cable operators to transmit high-quality video signals to their customers and to offer such additional enhancements as high definition television ("HDTV"). Digital technology also has furthered the ability of cable operators to offer more service options, including advanced two-way services such as high-speed Internet access, cable telephony, and video-on-demand.

Current A La Carte Offerings. Premium networks, such as HBO, Showtime, Cinemax, STARZ! and The Movie Channel, have been available for over 30 years on analog systems. Premium networks generally derive revenue from a single source – subscription fees paid by subscribers. These networks are distributed a la carte by MVPDs.[36] Premium networks charge subscription rates generally in the range of $10 - $15 per month. High subscription charges are necessary to support a premium network's expenditures for high-value content, which is costly to produce or acquire, and to allow the network to operate on a single revenue stream. The high subscription charges also are necessary because a la carte networks historically have had low subscribership levels. For instance, STARZ! has only 12 million subscribers, and even HBO, the largest premium service provider, has just 39 million subscribers, or less than half the subscribers of the largest niche networks.[37]

Premium networks display a distinct programming format. They deliver general-interest "high-value" content (*i.e.*, either original content or recent-release movies), presented advertising-free. This programming is designed to have broad appeal among viewers, rather than target a niche audience. A sub-

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[34] The digital tier offers programming that is digitally compressed for efficient delivery. The programming is then demodulated from digital to analog format for display on subscribers' analog television sets.

[35] *See 2003 Competition Report*, 19 FCC Rcd at 1637. According to newer data from the NCTA, there were 22.9 million digital subscribers as of March 2004. *See* http://www.ncta.com/Docs/PageContent.cfm?pageID=86.

[36] The typical distribution agreement between an MVPD and a premium network will specify a narrow range of distribution options available to the MVPD because these networks are designed expressly for a la carte distribution. A typical distribution agreement between an MVPD and a premium network entails a "revenue split," with each party receiving a negotiated percentage of the subscription fees paid by subscribers for the network, which are channeled through the MVPD. This is in contrast to the generally fixed-rate "per subscriber" license fee arrangement between MVPDs and niche networks, discussed below. Thus, while premium networks commonly are marketed as "purely" a la carte or as mini-tiers of premium networks, they almost never are distributed in a tier with numerous advertiser-supported program networks.

[37] *See* Joint Programmers Comments at 15.

category of premium networks consists of those that serve a micro-niche ethnic group or foreign-language speakers. Pricing for these networks is similar to, or even higher than, other premium networks. Indeed, for many viewers of these networks, particularly those with limited English-language skills, the network may be their only practical television programming option.[38] Cable operators are slowly migrating premium services from analog service to digital service, mainly because the digital environment is more secure rendering theft of service more difficult. In addition, a number of premium networks are now available in a high definition format.

Pay-per-view programming is another type of video service that is offered by MVPDs on an a la carte basis. Rather than paying for a channel of programming, like HBO, a subscriber pays for a specific program. With pay-per-view, cable and DBS subscribers can order hundreds of recently released movies or current sport events on a per-program basis. However, pay-per-view is not instantaneous, as subscribers must wait to view a selected program at a prescribed time.

Many new digital services offered by cable operators enable subscribers to maintain more control over what, when, and how they receive information, but the most important service for this discussion is video-on-demand. This service permits subscribers to instantaneously access video programming content on a program-by-program basis. VOD subscribers are able to pause, fast-forward, or rewind programming in the same manner as permitted by a VCR or by a digital video recorder.[39] Cable operators offer a mix of free and pay VOD. With regard to the latter, certain operators are offering subscription video-on-demand ("SVOD") which functions like VOD, but has a different marketing structure. Rather than paying for each event viewed, the subscriber pays a monthly fee to access certain programming on an at-will basis. For example, a subscriber would pay an additional $3.00 more per month for HBO which would allow him to access a catalog of programming for instantaneous viewing. The VOD choices provided by cable operators continue to grow as they further upgrade their systems and offer digital services. With the tier buy through rule[40] and VOD, cable subscribers are able to access hundreds of programming options without having to purchase a tier of service other than the basic service tier.

Picking programming. Television viewers find programming to watch on cable systems and DBS in many different ways. They can purchase print guides, such as *TV Guide*, or read the local television listings in the daily newspaper to find out what programming is available. Another way MVPD subscribers find programming is through an electronic program guide ("EPG"). EPGs are on-screen directories of programming delivered through various means, including cable, satellite, and over-the-air broadcast signals. EPGs come in two types: Original-generation and Interactive. Original-generation EPGs continually scroll programming listings. These EPGs are generally delivered as discrete video programming channels. Interactive EPGs, ("IPGs") allow users to sort and search programming, give program descriptions, provide reminders of upcoming programming, and take users to programming they select. Cable operators and satellite carriers currently provide EPGs to their subscribers.

Viewers who do not have access to a print guide or an EPG often rely on their remote controls to select programs to watch. Cable operators and satellite carriers offer service that corresponds to the way in which most viewers watch television. When, as is often the case, a viewer has not selected a specific program in advance, he or she is likely to "browse" or "surf" the channels until something interesting

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[38] *Id.*

[39] To offer VOD, a cable operator must install high-capacity video servers at its headend, and possibly in its hubs, as well as a digital set top box in the subscriber's home.

[40] *See infra.*

turns up.[41] Many viewers may not even be aware of the name of the channel on which they stop to take a closer look. The phenomenon known as "channel surfing" is now an integral part of the modern viewing experience, something that subscribers find to be very valuable.[42]

The practice of channel surfing is supported by market research showing that consumers often will not be aware of the name of a channel unless it appears before them, yet a substantial proportion of viewers will describe particular programs on the channel as being important to their overall enjoyment of cable as a service. According to a study from Knowledge Networks Statistical Research, of 2000 survey respondents, only 9 percent knew what was on television when they turned on their sets.[43] In contrast, 33 percent used an electronic programming guide to find out what was on television, while 23 percent "just flipped channels." These results are buttressed by a recent study commissioned by the Cable and Telecommunications Association for Marketing ("CTAM"), which found that viewers who start watching a new channel are most likely to find it by "just flipping through the channels."[44] Overall, 45 percent of the study's respondents indicated that they found new channels in this manner, and the percentage rises to 49 percent in digital cable homes.[45]

D. Current Requirements and Obligations

There are several statutory provisions and Commission rules that dictate the carriage and placement of certain types of video programming, including the basic service tier provisions and the channel availability provisions. Federal law also dictates, to a certain extent, a cable operator's technical obligations and its relationship with subscribers. These statutory provisions and Commission rules sometimes limit a cable operator's ability to freely offer a wide array of program packages.

1. Tier Placement Requirements

Under Section 614 of the Act, local commercial television station signals must be provided to every subscriber of a cable system.[46] These signals must be viewable via cable on all television receivers of a subscriber which are connected to a cable system by a cable operator or for which a cable operator provides a connection. If a cable operator authorizes subscribers to install additional receiver connections, but does not provide the subscriber with such connections, or with the equipment and materials for such

[41] One recent study found that about half of all cable and satellite TV viewers frequently flip through channels until they find something to watch. Research Alert, *How TV Viewers View TV*, Cable and Telecommunications Association for Marketing (Dec. 6, 2002).

[42] For example, 63 percent of analog tier subscribers and 65 percent of digital tier subscribers use channel surfing as the most used source to find out what is on television. Moreover, nearly 50 percent of cable customers rely on channel surfing to decide what to watch. *See* Cable Television Administration & Marketing Society, *Video Consumer Research Study*, September 2002. *See* Scripps Comments at 20.

[43]Knowledge Networks Statistical Research, *How People Use Television*, 2004, *available at* http://www.onetvworld.org/?module=displaystory&story_id=968&format=html.

[44] Lieberman Research Worldwide, *Tracking the Evolving Use of Television and Its Content*, March 2004, at 15.

[45] While channel surfing was the most common method for finding new channels by a significant margin, the next three most common methods were: (1) starting to watch a specific show on the channel (cited by 30 percent of respondents); (2) advertising on another channel (cited by 27 percent of respondents); (3) and word-of-mouth from friends or relatives (cited by 26 percent of respondents). *Id. See* Viacom Comments at 9.

[46] 47 U.S.C. § 534(b)(7); 47 C.F.R. § 76.56(d).

connections, the operator must notify such subscribers of all broadcast stations carried on the cable system which cannot be viewed via cable without a set top box and must offer to sell or lease such a set top box to its subscribers at regulated rates. The signals of noncommercial television stations must be available to every subscriber as part of the cable system's lowest priced service tier that includes the retransmission of local commercial television broadcast signals.[47]

Under Section 623 of the Act, a cable operator must also provide its subscribers a separately available basic service tier to which subscription is required for access to any other tier of service.[48] The basic service tier must, at a minimum, consist of the following: (1) all signals carried in fulfillment of the must carry requirements of Sections 614 and 615; (2) any public, educational, and governmental access programming required by the franchise of the cable system to be provided to subscribers[49]; and (3) any signal of any television broadcast station that is provided by the cable operator to any subscriber, except a signal which is secondarily transmitted by a satellite carrier beyond the local service area of such station.[50] A cable operator may add additional video programming signals or services to the basic service tier.[51] Satellite carriers are not required to have a basic service tier.

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[47] 47 U.S.C. § 535(h); 47 C.F.R. § 76.56(d)(2).

[48] 47 U.S.C. § 543(b)(7).

[49] Pursuant to Section 611 of the Act, local franchising authorities may require cable operators to set aside channels for public ("P"), educational ("E"), or governmental ("G") use ("PEG"). 47 U.S.C. § 531. Public access channels are available for use by the general public. Educational access channels are used by educational institutions for educational programming. Governmental access channels are used for programming by organs of local government. PEG channels are not mandated by federal law, and the Commission has no jurisdiction over them, rather they are a right given to the local franchising authority, which it may choose to exercise. PEG channels provide an important source of local and diverse information for cable subscribers. *See* H.R. Rep. No. 98-934, 98th Cong., 2d Sess., at 30 (1984) ("Public access channels are often the video equivalent of the speaker's soap box or the electronic parallel to the printed leaflet."). Satellite carriers do not have any PEG obligations because they are not franchised like cable operators, but they are required by the Act and the Commission's rules to reserve four percent of their channel capacity for access by qualified programmers for "noncommercial programming of an educational or informational nature." 47 U.S.C. § 335. Access to the reserved capacity on each DBS system must be offered at reduced rates and is limited to one channel per qualified program supplier. 47 C.F.R. § 25.701.

[50] Cable systems retransmit broadcast signals pursuant to the statutory copyright license, under which the cable industry carries thousands of broadcast stations and currently pays approximately $120 million in royalties to copyright owners each year. The statutory license requires cable systems to pay royalties based on a percentage of revenues associated with the tiers of service they offer that include broadcast station retransmissions. *See* 17 U.S.C. § 111(d); 37 C.F.R. § 201.17(b)(1). The cable statutory license and the specific royalty rates mandated by the license were enacted under the assumption that broadcast stations and program networks would be bundled in service tiers. A la carte regulation, in the context of the basic service tier, may raise several substantial questions about the manner in which cable systems would compensate copyright owners for the use of their copyrighted works. *See* Sports Leagues Comments at 11.

[51] *Id.* The Commission generally prohibits cable operators from scrambling the basic service tier. 47 C.F.R. § 76.630(a). This requirement ensures that all subscribers are able to receive basic service tier channels in the clear and that basic-only subscribers with cable-ready television sets will not need set-top boxes.

Digital Basic Service Tiers. It has been the Commission's view that the Act contemplates a single basic service tier.[52] When analyzing the basic service tier requirement in the context of a cable operators' digital broadcast signal carriage obligations, the Commission held that it is consistent with the statutory language to require that a broadcaster's digital signal must be available on a basic tier such that all broadcast signals are available to all cable subscribers at the lowest priced tier of service. The Commission opined that the basic service tier, including any broadcast signals carried, will continue to be under the jurisdiction of the local franchising authority, and as such, will be rate regulated if the local franchising authority has been certified under Section 623 of the Act.[53] The Commission noted, however, that if a cable system faces effective competition under one of the four statutory tests,[54] and is deregulated pursuant to a Commission order, the cable operator is free to place a broadcaster's digital signal on upper tiers of service or on a separate digital service tier.

Commercial Leased Access. Section 612 of the Act requires cable operators to reserve channel capacity for non-affiliated video program networks under a leased channel paradigm.[55] The Commission has adopted rules, pursuant to Section 612, for leased access channels addressing maximum reasonable rates, reasonable terms and conditions of use, minority and educational programming, and procedures for resolution of disputes.[56] The Commission's rules require cable operators to place leased access program networks on any tier that has a subscriber penetration of more than 50 percent, unless there are technical or other compelling reasons for denying access to such tiers.[57] Cable operators are permitted to make reasonable selections when placing leased access channels at specific channel locations. Cable operators may use the highest implicit fee formula, as set forth in the Commission's rules, to set maximum

[52] *See Carriage of Digital Television Broadcast Signals*, 16 FCC Rcd 2598, 2643 (2001) ("*DTV Must Carry Order*"). In its *First Rate Report and Order*, the Commission, citing provisions in the 1992 Cable Act that consistently refer to "basic tier" in the singular, concluded that the Act contemplates that each cable operator must offer only one basic tier. *See First Rate Report and Order*, 8 FCC Rcd at 5744. The U.S. Court of Appeals for the District of Columbia Circuit found that the Commission's single basic tier requirement constituted a permissible interpretation of Section 623(b)(7). *See Time Warner v. FCC*, 56 F.3d 151, 199 (D.C. Cir. 1995).

[53] *See* 47 U.S.C. § 543(a)(3).

[54] *See* 47 U.S.C. § 543(l)(1).

[55] 47 U.S.C. § 532. Commercial leased access set-aside requirements were established by Congress in proportion to a system's total activated channel capacity. Cable systems with 36 or more activated channels are required to comply with these set-aside requirements. *See* 47 U.S.C. § 532(b)(1). Section 612 permits cable operators to use any unused leased access channel capacity for their own purposes until a written agreement for the use of such leased access capacity is obtained. Each system operator subject to this requirement must establish, consistent with the rules prescribed by the Commission, "the price, terms, and conditions of such use which are at least sufficient that such use will not adversely affect the operation, financial condition, or market development of the cable system." 47 U.S.C. § 532(c)(1). The 1992 Cable Act amended Section 612 and broadened the statutory purpose to include "the promotion of competition in the delivery of diverse sources of video programming," and expanded the Commission's authority over leased access. 47 U.S.C. § 532(a).

[56] *See* 47 C.F.R. §§ 76.701, 76.970, 76.971, 76.975 and 76.977.

[57] 47 C.F.R. § 76.971(a)(1). According to the legislative history of the 1992 Cable Act amendments to the leased access requirements in Section 612, "If programmers using these channels are placed on tiers that few subscribers access, the purpose of this provision [to promote competition in the delivery of diverse sources of video programming and to assure the widest possible diversity of information sources are made available to the public from cable systems] is defeated. The FCC should ensure that these programmers are carried on channel locations that most subscribers actually use ... to ensure that these channels are a genuine outlet for programmers." *See* S. Rep. No. 102-92, at 79 (1991).

reasonable rates for leased access programming that is carried as an a la carte service.[58] The Commission evaluates disputes involving channel placement on a case-by-case basis and will consider any evidence that an operator has acted unreasonably in this regard.[59]

DBS. The broadcast station availability requirements for satellite carriers, pursuant to the carry-one-carry-all requirement of the Satellite Home Viewer Improvement Act of 1999 ("SHVIA")[60] and under Section 338 of the Act,[61] differ from those of cable operators. The Commission held that satellite carriers do not need to sell all local television stations as one package to subscribers, as is required of cable operators. Specifically, the Commission noted that Congress did not intend to establish a basic service tier-type requirement for satellite carriers when it implemented Section 338. Nor did Congress explicitly prohibit the sale of local television station signals on an a la carte basis. Rather, the Commission stated that Section 338's anti-discrimination language prohibits satellite carriers from implementing pricing schemes that effectively deter subscribers from purchasing some, but not all, local television station signals. The Commission therefore found that a satellite carrier must offer local television signals, as a package or a la carte, at comparable rates.[62] The broadcast industry specifically sought review of the Commission's a la carte rule. The United States Court of Appeals for the Fourth Circuit, in *SBCA v. FCC*, held *inter alia*, that the satellite carriage a la carte policy was not arbitrary, capricious, or contrary to law.[63]

2. Tier Buy-Through Requirements

Section 623(b)(8) of the Act provides that a cable operator may not require the subscription to any tier other than the basic service tier as a condition of access to video programming offered on a per channel or per program basis.[64] Under the tier buy through requirement, a cable operator may not

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[58] 47 C.F.R. § 76.970.

[59] National Religious Broadcasters ("NRB") state that a significant number of religious program networks secure carriage on cable television through commercial leased access. NRB believes that leased access should be maintained in its current state and not be subject to any type of a la carte requirement. *See* NRB Comments at 3.

[60] Pub. L. No. 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545 (1999). The provisions contained in the Satellite Home Viewer Improvement Act expire at the end of 2004.

[61] *See generally*, 47 U.S.C. § 338; 47 C.F.R. § 76.66.

[62] *See Implementation of the Satellite Home Viewer Improvement Act of 1999: Broadcast Signal Carriage Issues; Retransmission Consent Issues*, 16 FCC Rcd 1918, 1960 (2000) ("*DBS Broadcast Carriage Report & Order*").

[63] *SBCA v. FCC*, 275 F.3d 337 (4th Cir. 2002). Based on this precedent, Echostar notes that the Commission's rules do not appear to stand as an obstacle to carriage of local channels on an a la carte basis, at least for satellite carriers. Echostar Comments at 10.

[64] 47 U.S.C. § 543(b)(8). *See Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Buy-through Prohibition* ("*Tier Buy-through Order*"), 8 FCC Rcd 2274 (1993); 47 C.F.R. § 76.921. In response to the U.S. Court of Appeals for the District of Columbia Circuit's 1995 decision, *Time Warner v. FCC*, 56 F.3d at 199, the Commission modified its rules to state that the tier buy-through requirement, like other requirements under Section 623, does not apply to cable systems subject to effective competition. *Id.* There is no Federal requirement that cable operators inform their customers about the tier buy through rule. However, certain states are attempting to impose tier buy through notification requirements. *See* TR's State NewsWire, *Bill Requires Cable Companies to Notify Customers About Plans*, October 1, 2004 (Legislation is pending in New Jersey that would require operators to notify subscribers of their buy-through rights).

discriminate between subscribers to the basic service tier and other subscribers with regard to the rates charged for video programming offered on a per channel or per program basis.[65] In adopting rules to implement the tier buy-through prohibition, the Commission determined that multiplexed services (*i.e.*, multiple screens of a single premium service such as HBO East, HBO West, HBO Signature, etc.) are to be treated as per channel services.[66] Thus, a subscriber is not required to purchase any intervening tier or tiers of programming in order to subscribe to a multiplexed programming service. Moreover, a cable operator may require the subscription to one or more tiers of cable programming services as a condition of access to one or more tiers of cable programming services. The tier buy-through provision does not prohibit the use of a set-top box in order to receive per program or per channel services on an a la carte basis. The tier buy through rules do not apply to DBS.

3. Commercial Availability of Navigation Devices and Equipment Compatibility

Section 629 of the Act directs the Commission to adopt rules that would allow consumers the opportunity to obtain "navigation devices," such as cable set-top boxes and other equipment, from commercial sources other than their MVPD service providers.[67] Pursuant to Section 629, the Commission required MVPDs to unbundle security from other functions of the navigation device and to make available modular security components, called point-of-deployment modules ("PODs" or "CableCards"), to separately perform the conditional access function.[68] Thus, an MVPD subscriber would be able to obtain a set-top box or other navigation device without the security features from a retailer, and the MVPD would provide a card-sized POD module for security functions.

Section 624A of the Act directs the Commission to "issue such regulations as are necessary" to assure the compatibility between cable systems and consumer electronics equipment such as television receivers and video cassette recorders.[69] Section 624A(d) further directs the Commission to review and modify its compatibility regulations "to reflect improvements and changes in cable systems, television receivers, video cassette recorders, and similar technology."[70] The 1996 Act amended Section 624A to include the finding that "compatibility among television sets, video cassette recorders, and cable systems can be assured with narrow technical standards that mandate a minimum degree of common design and

[65] 47 U.S.C. § 543(b)(8)(A). If, in a proceeding initiated at the request of a cable operator, the Commission determines that compliance with the tier buy-through requirements would require the cable operator to increase its rates, the Commission may, to the extent consistent with the public interest, grant such cable operator a waiver from the requirements for a specified period as the Commission determines to be reasonable. *Id.* § 543(b)(8)(C).

[66] *Tier Buy-through Order*, 8 FCC Rcd at 2275 n.9.

[67] 47 U.S.C. § 549. The Commission defines navigation devices as "converter boxes, interactive equipment, and other equipment used by consumers within their premises to receive multichannel video programming and other services offered over multichannel video programming systems." 47 C.F.R. § 76.1201(c).

[68] *Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices*, 13 FCC Rcd 14775, 14776 (1998); 47 C.F.R. § 76.1204.

[69] 47 U.S.C. § 544A. The analog equipment compatibility rules were developed ten years ago. *See Compatibility Between Cable Systems and Consumer Electronics Equipment*, 9 FCC Rcd 1981 (1994) ("*Compatibility Report and Order*").

[70] 47 U.S.C. § 544A(d).

operations, leaving all features, functions and protocols, and other product and service options for selection through open competition in the market."[71]

Pursuant to its authority under Section 629, the Commission has adopted rules to require television sets to be built with "plug-and-play" functionality, *i.e.*, the ability for a consumer to attach a "digital cable ready" digital television receiver directly to the cable system using a POD and receive one-way cable television services, without the need for a set-top box.[72] Since July 1, 2004, cable operators have been required to support unidirectional digital cable products ("UDCPs") by providing a CableCard to any subscriber who purchases a digital cable ready product and requests connection to the cable system without a set-top box.[73] At this time, consumers will still need a set-top box to receive two-way (*i.e.*, interactive) services, such as video on demand, pay-per-view, and cable operator-enhanced electronic programming guides. The cable and consumer electronics industries continue to work on the development of an agreement for two-way "plug-and-play" receivers.[74] Charter comments that an a la carte mandate would likely require more set-top boxes in subscribers' homes, a move which it believes would contradict all plug and play efforts that permit subscribers to access digital cable service without additional equipment.[75]

E. Analysis of Current Packaging Practices at the Retail Level

The attraction of introducing price discipline and additional choice into the retail market for video programming is obvious. Over the past five years, cable prices have increased by an average of 4.6% per year according to the Bureau of Labor Statistics. The FCC's "Report on Cable Industry Prices" shows dramatic annual increases, in excess of 7%, for the expanded basic program tier over the past five years. Accompanying these rate increases have been increases in the number of channels contained within the expanded basic package, though the size of the package has not kept pace with the rate increases. As the price and size of the expanded basic tier rises, consumers have begun to ask themselves if the additional channels are actually worth the additional costs. Consumers have reason to question whether current packaging practices contribute to the problem. This section will examine whether there are any benefits to the current method of selling video programming and the extent to which current practices are the root cause of many of the problems in the retail market. In the sections that follow, a la carte and themed tiers are examined to determine if they can provide a check on rate increases, provide additional choice to consumers, and give them more control over the content that enters their homes.

1. Benefits and Harms of Bundling at the Retail Level

a. Consumer Choice and Rates

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[71] 47 U.S.C. § 544A(a)(4).

[72] *Compatibility Between Cable Systems and Consumer Electronics Equipment*, 15 FCC Rcd 17568 (2000) ("*Digital Compatibility Report and Order*"); *Compatibility Between Cable Systems and Consumer Electronics Equipment*, 18 FCC Rcd 20885 (2003) ("*Digital Compatibility Second Report and Order*"); 47 C.F.R. §§ 15.123, 76.640, 76.190 *et. seq.*

[73] 47 C.F.R. § 76.640(b).

[74] The *PN* specifically sought comment on the impact an a la carte and themed-tier requirement would have on the uni-directional plug-and-play regulations, and on the ongoing discussions regarding potential bi-directional plug-and-play regulations. *PN*, 19 FCC Rcd at 9293. Very few parties mentioned this topic in their pleadings.

[75] *See* Charter Comments at 11.

Consumers Union and the Consumer Federation of America, among others, state that cable rates have increased at nearly three times the rate of inflation. They argue that the industry's practice of making most networks available only as part of a bundle or tier has contributed to the rise in rates. They argue that the size of these bundles far exceed the number of channels that the average household regularly watches. This has resulted in consumers paying for channels that they do not watch. By exposing the underlying demand for an individual channel, rather than hiding it in the bundle, they contend that cable operators will be forced to offer programming that consumers are willing to purchase. They maintain that offering channels on an individual basis, as well as in existing tiers, will provide consumers with additional choice and act as a strong check on cable rate increases.[76] Some individual consumers also filed comments supporting the argument that they are paying for channels they do not watch and that their rates would be lower if they were able to purchase channels on an individual basis.[77]

Rural Telephone Companies ("RTCs") state that a la carte and tiering can exist side-by-side and actually increase consumer choice and reduce programming costs at the same time. They use the current premium services business model to explain their position. Twenty-five years ago, premium services were single channel services offered strictly on an a la carte basis. Today, those same services are offered in multiplex packages as well as in packages with additional premium services (i.e., themed-tiers) at rates equal to or less than what the individual services cost when they were offered alone. RTCs state that, in real dollars, the rate for each premium service has gone down while the diversity of services has gone up. Yet, those same premium services are still available on an a la carte basis should a subscriber wish to purchase them that way. RTCs conclude that while subscriber choice and diversity has increased, programming costs to the consumer have decreased.[78]

Cable operators and program networks disagree that bundling practices in the MVPD market have limited consumer choice. Furthermore, many argue that any move away from the current system will not lower rates, but will increase them.[79] The impact of a shift to a la carte or themed-tiers on rates is extensively examined below and illustrates many of the benefits of bundling that would be lost. Among these benefits are the cost savings that bundling engenders.

Joint Programmers state that some groups appear to believe that subscribers would be able to purchase a limited number of networks a la carte from a broad bundle of networks, and that those networks could be purchased at a price "per network" that is roughly proportionate to each network's

[76] CU/CFA Comments and Reply Comments, *passim*.

[77] One individual claims that "[i]n an a la carte world, we would actually see some value for the money we spend on cable. As it is now, we do not. Cable companies argue there will be less choice. I disagree strongly. A choice between options you don't want is no choice at all!" *See* Comment of Margot Durrett, Cloverdale, CA.

[78] RTC Comments at 14.

[79] Several individual commenters opposing a la carte focus on the potential problem of increased rates. One commenter asserts that "options for a la carte channels . . . would needlessly raise rates for programming which . . . are outrageous to begin with." *See* Comment of Wanda McDaniel, Powder Springs, GA. Another commenter states that "we would pay the same amount for a few channels that we pay for a lot – we [would] lose the volume discount." *See* Comment of Shandle Green, Pasadena, CA. Several individuals conclude that '[t]o require cable programmers to tailor their product to every last subscriber would raise prices through the roof, and limit channel selections to only the lowest common denominator of broadly popular channels." *See* Comments of Karen Gonzales, Fallon, NV. *See also* Comments of Charles Cooper, Chesterhill, OH, Gerald Zellar, Lakefield, MN, Frances Turner, Galena, OH, Randy Gordon, Gastonia, NC, J.J. Harmon, Jr., Bluefield, VA.

share of the overall price of the bundle.[80] Under this theory, if consumers currently subscribe to a tiered offering of 40 networks for $30, they instead should be able to subscribe to only their favorite networks for 75¢ each. Joint Programmers state that this perception ignores the fundamental nature of video programming, but it does much to explain the appeal of a la carte distribution among a part of the public.[81]

Potentially distinct products are often bundled in order to lower transaction costs, realize economies of scale, and enhance the attractiveness or convenience of the product to consumers. Many commenters, including Charter and Courtroom Television, state that the benefits of bundling are perhaps best illustrated by considering the daily newspaper. In the sale of newspapers, for example, the various sections and columns are bundled into a single product, even though few people read all parts of the paper. But a newspaper is sold as a bundled product because: (1) of the economies of having all sections delivered at once rather than having separate distribution mechanisms for each section; (2) of the value to subscribers of having the option to look at all of the sections, even if they do not read all sections every day; and (3) of the efficiencies for advertisers who prefer paying a single price to reach all of the newspaper's readers with a single advertisement.[82]

Bundling also simplifies consumer decision-making. Comcast states that a la carte, the opposite of bundling, likely would provide tens of thousands of possible program combinations that would not be attractive to consumers.[83] Comcast states, for example, that a restaurant with a menu of over 10,000 items would be so extensive and complex that it would leave consumers confused and frustrated. The same is true of a la carte.[84] According to the Progress and Freedom Foundation ("P&FF"), tiering accomplishes a number of purposes, one of which is to provide viewers with "option value." When viewers purchase a bundle of programs, they have the option of watching programming that they might not have purchased separately.[85]

According to Comcast, the benefits of retail bundling are readily apparent in the cable industry. Tiers lower distribution costs because the distribution cost entailed in serving a subscriber is the same regardless of the number of channels delivered, so the more channels subscribed to, the lower the average cost of distributing a channel.[86] In a similar fashion, Charter asserts that if relatively few customers subscribe to relatively few cable services, the delivery plant is under-utilized. As a result, the average fixed cost per unit of channel delivery is relatively high. In contrast, if many customers subscribe to large numbers of cable services, the average fixed costs per unit of channel delivery is relatively low. As the

[80] Joint Programmers Comments at 36.

[81] *Id.*

[82] *See* Courtroom Television Comments at 14; Charter Comments at 6.

[83] Comcast Comments at 11.

[84] Research suggests that most consumers prefer simplified choices when there are a large number of alternatives to consider. *See* Ravi Dhar, *Consumer Preference for a No-Choice Option*, Journal of Consumer Research, September 1997, Vol. 24, No. 2, at 215.

[85] P&FF Comments at 9.

[86] Comcast Comments at 7.

price per unit of channel delivery declines, the customer benefits, because a greater percentage of the customer's subscription fees is available for programming.[87]

Turner states that households effectively cross-subsidize each other so that the price for the networks they want is less than the price they would have to pay if they were only buying the program networks they valued most highly. Turner states that the correct way of looking at this market is that network users collectively support the joint costs of creating video services. Different users pay for different uses of the network, but no consumer pays more for the expanded basic tier than the value of the service they receive.[88]

It is this explanation which has motivated much of the economic research on the benefits of bundling in the video programming industry.[89] Research suggests that video programming has one characteristic that leads to the unusual results with respect to bundling. Regardless of how many persons view, or consume, such programming the costs of production do not change. Because of this characteristic, social welfare is maximized when distribution of programming is maximized. However, a product with this characteristic that is sold on an individual basis with a uniform price may not be able to recover its fixed production costs, even though the total value consumers place on the good is greater than those production costs. In short, bundling by MVPDs allows program networks to recover a large share of the production costs from consumers who value the programming the most, while obtaining a smaller contribution from consumers that do not value the programming as highly. Bundling does not force consumers to pay for programming they do not want, but it does force them to pay more for programming that they value highly than the amount another consumer who values that programming less highly pays. In the end, this result ensures the production of programming that consumers value by spreading those costs over a broad segment of society. In addition to the benefit bundling confers on the diversity of programming, it also appears to promote fiercer competition between MVPDs. Economic research indicates that two firms that compete with each other by selling bundles have lower prices than firms that compete through a la carte sales.[90]

b. Objectionable Content

CU states that giving consumers the choice to select only those program networks they want, on an a la carte basis, provides a solution to the "growing public concern" about violent and indecent programming. It states that rather than putting the government in the untenable position of trying to curtail objectionable content, a la carte consumers could select desired programming and reject offensive programming.[91]

The Commission does not have specific statutory authority to regulate the content of non-broadcast program networks. The cable and DBS subscription business model, and its ability to provide tools to block unwanted programming, differentiate these distributors from traditional television

[87] Charter Comments at 9.

[88] Turner Reply Comments at 4, 9.

[89] Section I of the Economic Appendix discusses economic research in this field.

[90] Yannis Bakos and Erik Brynjolfsson, *Bundling and Competition on the Internet*," Marketing Science, 19(1), Winter 2000, at 63-82.

[91] CU Comments at 4.

broadcasting.[92] The Act provides cable subscribers with a variety of measures to block unwanted programming. First, under Section 624, cable operators must provide "lockbox" technology to cable subscribers upon request to prevent the viewing of any channel on which objectionable programming may appear. Cable operators are required to make lockboxes available for sale or lease to customers who request them.[93] Second, under Section 640, a cable operator is required to fully scramble or block the audio and video portions of programming services not specifically subscribed to by a household. The cable operator must fully scramble or block the programming in question upon the request of the subscriber and at no charge to the subscriber.[94] Finally, subscribers may purchase television sets equipped with V-Chips that enable individuals to block television programs assigned a particular rating by the video programmer.[95] While the latter mandate applies to all MVPD homes with television sets, the first two subscriber protections do not apply to DBS because they are not subject to the provisions of Title VI, although as discussed below, DBS has created its own subscriber protection tools.

Earlier this year, a group of cable operators, representing about eighty-five percent of all cable subscribers, launched a campaign to educate cable subscribers on parental tools and consumer rights, including explanations of the TV ratings system, V-chip, and program blocking technology.[96] This campaign includes public service announcements, media literacy workshops, technical assistance with program blockers, and a website.[97]

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[92] *See, e.g., Cruz v. Ferre*, 755 F.2d 1415, 1419 (11th Cir. 1985) ("Unlike broadcast television, which send over-the-air signals, cable television operates by transmitting programs to subscribers through coaxial cables or wires."); *Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, 17 FCC Rcd 23246, 23328 (2002) (cable services "are not broadcast services, but are subscription-based services, which do not call into play the issue of indecency"). *See also*, *Litigation Recovery Trust*, 17 FCC Rcd 21852, 21856 (2002) (broadcast indecency restrictions not applicable to satellite programming provided to hotels); *Harriscope of Chicago, Inc.*, 3 FCC Rcd 757, 760 (1988) ("Consistent with existing case law, the Commission does not impose regulations regarding indecency on services lacking the indiscriminate access to children that characterizes broadcasting."). However, Sections 639 of the Act and 18 U.S.C. §1468(a) respectively prohibit the transmission of obscene material over a cable system and the knowing utterance or distribution of obscene matter by means of a cable television system or subscription service. 47 U.S.C. § 559; 18 U.S.C. § 1468. Only the latter provision applies to DBS.

[93] 47 U.S.C. § 544(d)(2).

[94] 47 U.S.C. § 560.

[95] *See* 1996 Act, Section 551—Parental Choice in Television Programming. *See also* 47 U.S.C. § 544(d)(3) (when a cable operator provides access to premium channels without charge to subscribers (as a free preview or promotion) the operator must (1) give notification to subscribers of the impending free access, (2) inform subscribers that they have the right to request that the premium channels be blocked, and (3) block the premium channel upon request.)

[96] NCTA White Paper, *Cable Industry Efforts to Empower Television Viewers: Choice, Control, and Education*, February 2004; NCTA Press Release, *Cable Puts You in Control: Cable Industry Launches Consumer Education Initiative*, March 2, 2004; NCTA Press Release, *ControlYourTV.Org Website Launched as Cable Operators Commit to Offering Blocking Technology at no Additional Charge; Networks Reaffirm Use of TV Ratings*, March 23, 2004; NCTA Press Release, *Families Should Develop Media Plan to Take Control of Media Usage*, April 2, 2004.

[97] *See* Steve Donohue, *Cox Wants to Help Parents 'Take Charge!,* Multichannel News Online, August 26, 2004, available at http://www.multichannel.com/article/CA447950.html?display+Breaking+News&referral+supp ("Cox Communications, Inc. launched a new public-affairs program designed to help parents control the content their kids see on television and the Internet.").

Commenters generally state that an a la carte requirement, for the purposes of blocking objectionable content, is unjustified and unnecessary in light of the Act's consumer protection provisions and the advanced technical tools provided by MVPDs. For example, Joint Programmers argue that it is unfair and inappropriate to burden the majority of program networks who do not present indecent programming, with an "overkill" solution apparently targeted at only a handful of networks, especially when parents already have the complete ability to block any objectionable programming or networks at no cost.[98] Religious Voices in Broadcasting ("RVB") states that the flexibility of having access to all cable channels, combined with the control to limit access to specific channels deemed inappropriate for certain household viewers, gives subscribers the power to regulate the indecent programming entering their homes without sacrificing the diversity of available programming.[99] LeSEA and Christian Television Network ("CTN") advocate content blocking technology, or "simple refusal to watch television," as a more effective means of avoiding undesired programming than a la carte.[100]

Comcast states that far more powerful and flexible tools are available to customers who choose to purchase digital cable service. Comcast's "Parental Control" feature on digital cable boxes, accessed by remote control through the menu of the electronic program guide, allows parents to block what their children can watch based on various criteria: by channel, program title, TV or MPAA rating, or time of day. Comcast asserts that parents can effectively create a "family tier" by using the "favorites" feature to select the channels they want their families to watch and by using parental controls to block the channels and programs they do not want their families to watch.[101] Comcast further states that, starting in June of this year, it has made it a condition of any new carriage agreement with any program network that the network provide ratings for all of its programming. Also in June, Comcast began requiring any program network over which it exercises management control to either confirm that it currently provides television ratings information for its programming or start providing ratings information.[102] DirecTV states that since it launched service 10 years ago, it has offered a free parental viewing "locks and limits" control feature on all DirecTV receivers, enabling parents to restrict access to channels. This feature is available on every DirecTV system receiver and is easily accessed via the DirecTV system remote control. According to DirecTV, all of its customers can avoid unwanted networks "quite easily."[103]

The Parents Television Council ("PTC") complains that parents have to pay for program networks that they do not want their children to view in order to access program networks for children.[104] In response, Comcast states that "neither economic logic nor market facts" support the view that tiers force consumers to pay for programming they do not want.[105] Comcast, as well as Time Warner, assert that a la carte will lead to higher prices for fewer program networks; thus, there are no cost savings in

98 Joint Programmers at 70-71.

99 RVB Comments at 7.

100 LeSEA and CTN Comments at 8.

101 Comcast Reply Comments at 14.

102 *Id.* at 15.

103 DirecTV Comments at 2-3.

104 PTC Comments at 1.

105 Comcast Reply Comments at 16.

return.[106] A&E states that "The fact that the very bundling that a la carte advocates rail against is what keeps per-channel prices low means that unbundling MVPD programming will require consumers to pay a premium for avoiding unwanted content that they can block now for free."[107] As a tool to allow subscribers to block objectionable content from reaching their homes, an a la carte requirement seems to be a particularly blunt instrument. Technical solutions that block unwanted content exist today at a lesser cost than a mandated a la carte requirement.

F. Feasibility of A La Carte and Themed-Tiers

In this section, the focus is on the impediments to mandatory a la carte, as well as the harms such a requirement would likely impose on MVPDs, as well as program networks.

1. Alleged Harms and Benefits

Studies and analyses. Several commenters submitted economic analyses noting the harms and costs associated with a la carte regulation. One such study is provided by Booz Allen and Hamilton on behalf of NCTA.[108] The highlights of the Booz Allen study are summarized below. The Bureau performed an independent analysis and critique of the Booz Allen study, the results of which are found in Part II of the Economic Appendix.

Booz Allen Hamilton examined three prototypical scenarios: (1) a "pure" a la carte approach under which all networks currently available on basic and expanded basic tiers were available only on a per-channel, a la carte basis; (2) an "optional" ("voluntary") a la carte approach, under which networks could continue to be packaged and offered on their current tiered basis, but would also be available on an a la carte basis to those customers who wanted to purchase fewer than all tiered networks; and (3) a themed tier approach under which cable operators were required to offer one or more smaller packages of programming based on content, in addition to the more inclusive currently available basic and expanded basic tiers.

According to NCTA, Booz Allen confirmed that "[u]nder each of the scenarios evaluated, consumers would be worse off than today. Consumers would either pay more than today for far fewer channels, or would need to select as few as six channels to reduce their monthly bill below current levels." NCTA states that the Booz Allen study also shows that because of the costs associated with offering an a la carte or themed tier option, even those cable customers who chose to continue to purchase the existing tiers would have to pay significantly more than they do today.[109]

NCTA also states that the Booz Allen study projects that the number, quality and diversity of program networks would all be severely diminished under a la carte. According to NCTA, Booz Allen concludes that "[a]s many as half to three-quarters of emerging networks could fail under each of the scenarios, including a growing number of targeted niche and ethnic programming networks, and new network launches would become extremely unlikely." Furthermore, "even the most established networks would likely have to reduce their expenditures on programming, leading to lower viewing and lost

[106] *Id.* at 17; Time Warner Reply Comments at 6.

[107] A&E Reply Comments at 20.

[108] NCTA Comments, *passim*. *See* Appendix D, for a complete list of studies submitted by commenters.

[109] NCTA Comments at 11.

advertising." In the end, this would not only diminish the number of available program networks but also "would likely lead to further industry consolidation into fewer network groups."[110]

Disney asserts that because a la carte would decrease revenues and add increased costs, the retail price for individual a la carte channels would be very high. The reality that even a few a la carte channels would cost the customer as much or more than the expanded basic bundle, would create a backlash against programmers, MVPDs, and the government. According to Disney, the result would be inevitable pressure on the government to intervene even further in the form of attempted price controls.[111]

2. Implementation

a. Structural Impediments

Technical. The *PN* asked whether an addressable set top box would be required for every television set on which a subscriber views programming offered on an a la carte or themed-tier basis. The *PN* specifically inquired whether an addressable set top box would be required for every television set on which a consumer might wish to view digital programming. The *PN* sought comment on whether a la carte or themed-tier services can only be offered on a digital basis. It also sought comment on the number of television sets that are not currently connected to addressable set top boxes and the costs to consumers of buying or leasing these boxes. The *PN* sought comment on the percentage of cable and satellite distributors that offer digital programming to their subscribers as well as how many consumers currently subscribe to digital programming packages.[112] There appear to be several technical obstacles preventing cable operators from offering all programming on an a la carte basis, especially since virtually all operators still offer program networks in an analog format.

According to Insight, a mandatory a la carte requirement that affects the expanded basic tier would force it to select one of the following four costly options to enable the delivery of a customized mix of program networks to each subscriber: (1) use a series of customized traps capable of blocking each of the channels on the analog expanded basic tier; (2) deploy hybrid set-top boxes to each subscriber that can descramble both analog and digital channels; (3) simulcast all of the basic and expanded basic channels in analog and digital format; or (4) convert to an all-digital platform.[113]

As for the first option, Insight states that traps have significant technical limitations. For example, it is difficult to restrict the impact of traps to just one channel because of the rudimentary nature of the technology. According to Insight, it is not uncommon, particularly as traps age, for the lower adjacent channel's audio signal to be attenuated, causing problems with stereo reception, or in more severe cases, monaural audio reception. Depending on where particular channels are located and which particular channels are selected by an a la carte customer, Insight asserts that it may be impossible to adequately deliver selective individual channels when those channels are interlaced with unwanted channels on the system's channel lineup.[114] Second, there is a physical and technological limit on the number of traps that can be used in any given situation. Insight states, for example, that attaching more

[110] *Id.*

[111] Disney Comments at 27.

[112] *PN*, 19 FCC Rcd at 9293.

[113] Insight Comments at 5.

[114] *Id.* at 6.

than four or five traps on a single aerial installation can cause safety, mechanical and electrical problems, including signal leakage issues. Third, the use of traps raises unacceptable signal quality issues. Fourth, the customer service and installation costs involved with the trap approach would be enormous. Finally, the widespread use of traps is unacceptable because it is perhaps the least effective signal security technique.[115] Moreover, trapping cannot be done from the headend, but rather requires a visit by a technician to the customer's premises. According to Smaller Operators, implementation of changes in a subscriber's selection of a la carte programming through traps would require technicians to make repeated truck rolls to the customer location.[116]

Blonder Tongue suggests that traps are not necessary to provide subscribers access to channels on an individualized basis; rather, cable operators may use an interdiction device ("addressable tap") that is placed on the cable plant outside a customer's home. Here, a signal is sent over the cable system with instructions to block a particular program service so that it does not enter the customer's home.[117] Recognizing that most addressable taps are only capable of controlling access to a limited group of channels at a time, Blonder Tongue states that it has a product, known as the TV Channel Blocker ("TVCB"), which can control up to 80 individual channels without adjacent channel degradation.[118] Comcast asserts that these types of interdiction devices are expensive, require cable operators to send a cable technician to every home for installation, can create a theft of service risk, and may not have the capacity to handle the dozens of analog channels delivered by cable systems today.[119]

The second alternative to offer expanded basic channels on an a la carte basis would be to deploy hybrid analog and digital addressable set-top boxes that allow a la carte customers the ability to receive only those specific analog expanded basic channels they have selected, while at the same time allowing them to continue to have the ability to receive digital services. This would require all expanded basic channels to be encrypted, and the use of set-top boxes with analog descrambling technology to deliver only those specific analog channels requested by a particular subscriber. Insight comments, however, that

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[115] *Id.* at 7-10. Traps can easily be tampered with by those trying to steal cable services. Widespread deployment of traps would exacerbate existing theft of service incidences and make it even more challenging for cable operators to prevent such activity.

[116] Smaller Operators Comments at 6.

[117] Interdiction is a technique cable operators use to block access to a channel by altering the horizontal sync pulses in the video signal to make the picture unwatchable. In order to view the picture, "instructions" are needed on how to reverse the alteration of the sync pulses. Systems using addressable taps typically send their signals in the clear; the signals that are not paid for are scrambled as they pass through the tap (the electronic circuitry in the tap performs interdiction on those signals), while the signals that are paid for are allowed to pass through the tap. These taps are addressable and can be controlled at the headend, thus eliminating the need to dispatch a technician for any programming changes. Like traps, interdiction devices eliminate the need for set-top boxes as the signals are controlled before entering the house. However, each TV, VCR, and similar device in the home will receive the same channel line-up.

[118] The TVCB, like other addressable taps, must be installed throughout the cable plant and at the customers' premises. A control system and software must be installed to allow the operator to remotely control the functions of all the addressable taps in the system. There must be an interface to link the billing system with the control system. The addressable taps are active devices, meaning that they need power to operate, so additional power would need to be supplied on the coaxial cable for the taps to function. Interdiction devices are only viable for analog deployments as they take advantage of the analog components of a video signal (the alteration of the sync pulse). The TVCB can only block 6 MHz analog channels; it is not capable of blocking out an individual digital stream.

[119] Comcast Reply Comments at 25.

because analog descrambling technology is becoming obsolete and security is readily compromised, set-top boxes with analog descrambling technology of any sort are no longer manufactured by, or available from, major set-top box manufacturers. According to Insight, the most important component, the integrated circuit devices used to segregate and descramble analog signals, have been discontinued by all major suppliers. Thus, the deployment of this approach would require further design, investment and manufacturing commitments in an obsolete technology. Insight states that even if such boxes were readily available, the cost to install them would also be prohibitive as each customer ordering a la carte service would require both a box on each television set within its residence and an installation truck roll by a service technician each time a television set and set-top box is connected to the system.[120] Smaller Operators state that hybrid addressable boxes similarly would not work as a means of implementing a la carte or themed tier service offerings because cable operators would need to scramble all networks in order to implement such programming options.[121]

The third approach described by Insight would be to allow non-a la carte customers the option to continue to receive analog only basic and expanded basic service tiers, while at the same time implementing a digital simulcast of those same signals, allowing customers to elect to receive expanded basic program services digitally on an a la carte basis so that those customers who choose a la carte would have to subscribe to the digital tier. Every customer electing a la carte would then need a digital addressable set-top box for every television in his or her home. The set-top box costs associated with such a solution would ultimately depend on the number of customers electing to receive their services a la carte, but would cost Insight a minimum of $200 per box, and would result in an increase in the subscriber's bill of approximately $8 per month, per box -- and about $13 per month for boxes with high definition and digital video recorder capabilities. Additionally, Insight states that band pass traps would need to be installed to block out the analog expanded basic tier channels for customers subscribing to a la carte services.[122]

Insight asserts that a simulcast approach would also constitute a massive waste of bandwidth, limiting a cable operator's ability to offer innovative non-basic services. In order to duplicate the analog basic tier on a digital tier, it would have to allocate additional spectrum on each of its systems. Insight generally uses this spectrum for other services including digital programming, HDTV, video-on-demand, high-speed cable Internet, circuit-switched telephony, and is actively exploring future uses, such as

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[120] Insight Comments at 11.

[121] Smaller Operators Comments at 6.

[122] Insight Comments at 14. Notwithstanding its investment of approximately $420 million to upgrade its network to enable its cable systems to offer a wide range of digital services, Insight states that all of its systems still currently deliver the basic and expanded basic tier channels via analog transmission. For many reasons, including the desire not to have to use any set-top equipment or buy a digital cable-ready TV set, the remainder of Insight's subscribers continue to choose to take only analog basic and/or enhanced basic service. Only about 33.5 percent of Insight's customers have chosen to take digital services at this time and Insight's marketing research indicates that a sizable proportion of its customers will continue to choose the analog lower cost option. Insight remarks that the upside of this approach is that it best respects the interests of these subscribers, as analog basic tier channels would remain unchanged on the system in order to continue to serve those non-a la carte customers who do not want a set-top box. *Id.* at 16.

VoIP.[123] Insight believes it would be an "enormous waste" to delay or reverse deployment of such services in order to duplicate analog programming that consumers can already receive.[124]

The fourth technical approach would involve the conversion of all analog services carried on the basic and expanded basic tiers to digital for transmission to all customers. This would require all customers to obtain and install new addressable digital set-top boxes on every set connected to cable in each subscriber's home. Insight comments that those customers who receive the entire expanded basic package in analog today, without a set-top box, would require a digital set-top box on each set in their homes just to continue receiving the same services, even if they have no desire to order any such channels on an a la carte basis.[125] Disney argues that all of the harms associated with mandatory a la carte, such as the need for set top boxes, would be the same for mandatory themed tiers.[126]

Charter admits that a digital-only operation would provide potential benefits other than simply accommodating an a la carte regime. Nevertheless, Charter notes that it is in the early stages of an all-digital roll-out in one of its systems (Long Beach, CA), and expresses concern that federal intervention might complicate, rather than facilitate, the migration to digital. Even in Long Beach, where Charter is now digitally simulcasting its analog services, it is not yet prepared to terminate analog service and require universal set-top box deployment.[127]

With regard to competition from satellite carriers, Charter states that DBS, which already relies on a digital platform and set-top boxes, could technically accommodate an a la carte mandate much more easily than could the cable industry. Charter and others urge that the government not unilaterally favor one MVPD over another.[128]

In order to accommodate a la carte using any method requiring addressable set-top boxes, Comcast states that cable systems would also need to upgrade the processing power of the Digital Access Control ("DAC") in their headend. The DAC is a cable system's main processor that handles the communications between the order-taking system, the billing system, and a customer's set-top box. Because a la carte would present exponentially more purchase options and require a three- to four-fold increase in the number of set-top boxes deployed in customers' homes than in today's tiered environment, the processing power of the DAC would need to be much greater than is typical of DACs in most cable systems today.[129] Not only would the DAC need to be upgraded to accommodate the expanded purchase options available under a la carte, and the additional set-top boxes deployed, but Comcast asserts that its system architecture would have to be expanded to allow VOD service to be provided to the additional

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[123] According to Insight, in a typical system with 45 analog expanded basic channels, using 12:1 digital compression, at least an additional 24 MHz would have to be reallocated for digital duplication of analog signals, and thus would become unavailable for advanced broadband services. *Id.*

[124] *Id.*

[125] *Id.* at 12; NCTA Reply Comments at 18.

[126] Disney Comments at 25-26.

[127] *See* Charter Comments at 11 (The results of the Long Beach trial, which is only one of more than 700 systems, will not be known for some time).

[128] *Id.* at 16; Smaller Operators Comments at 3.

[129] Comcast Comments at 38.

boxes. Changes to the cable plant would include substantial increases to the server capacity, headend processing equipment, data transport, and node deployment to ensure that the VOD service would continue to operate. Comcast estimates that the cost of upgrading the DAC for a la carte and protecting the integrity of its VOD offerings could be approximately $7-$8 million in its D.C., Northern Virginia, and Maryland region systems alone.[130]

Past Practices. The National Association of Telecommunications Officers and Advisors ("NATOA") suggests that the cable industry claims that a la carte is not practical, is at odds with the previous history of cable operators' attempts to use a la carte to avoid rate regulation in the early 1990s.[131] NATOA adds that since the deregulation of the CPST in 1999, there have also been no regulatory barriers to a cable operator's ability to offer such choices to subscribers. NCTA disputes NATOA's argument, explaining that most of these systems made only a small number of their expanded basic tiered services available on a per-channel basis, so that they were able to use physical traps to make them available in the same a la carte manner as premium movie channels.[132] Those systems that offered most or all of their tiered services available on an a la carte basis typically used interdiction. The alternative to interdiction was to use addressable analog set-top boxes. But that approach, unlike interdiction, would have required that all analog channels be "scrambled," and that all cable customers, even those with cable-ready sets who purchased no premium movie channels, use a set-top box to unscramble and receive their programming. According to NCTA, neither approach was particularly widespread because it made little economic sense for anyone to purchase services at the a la carte prices at which they were available. NCTA states that tiered and packaged services were offered a la carte because this exempted the packages and tiers from the Commission's rate regulation rules, not because a la carte was viewed as an optimal or desirable way to meet the marketplace demands of cable customers.[133]

b. Operational Impediments

Cable operators and satellite carriers indicate that an a la carte requirement would not only be technically challenging, but would also entail substantial marketing, billing, and other operational expenses that would drive up consumer costs.[134] Comcast states that the conversion to a la carte would be so massive and complex that it would effectively occupy the full attention of virtually all of a cable system's management, technical, and customer service personnel for an extended period of time. As a result, the roll out of advanced new services that consumers highly value would be delayed, and the length of the delay could be significant.[135] By way of comparison, the conversion from analog to digital took 18-36 months in Comcast's cable systems. A similar delay could be expected with a conversion from the current tiered model to an a la carte model. Comcast states that such a delay is plainly at odds

[130] *Id.* at 39.

[131] NATOA Comments at 3. *See supra.*

[132] NCTA Reply Comments at 19-20.

[133] *Id.*

[134] *See, e.g.*, DirecTV Comments at 5-8; Smaller Operators Comments at 5-10; Insight Comments at 4-22; NCTA Comments at 27-28; and Time Warner Comments at 8-9.

[135] Comcast Comments at 40.

with the Commission's policy of promoting the digital transition and the deployment of advanced new services.[136]

Insight asserts that an a la carte approach would also create insurmountable impediments to the establishment of convenient and readily marketable price points. According to Insight, DBS enjoys a significant marketing advantage over cable operators in that DBS can establish uniform, nationwide package prices, thereby enabling ubiquitous marketing through a variety of broadcast, print and other media with national distribution. Insight states that an a la carte approach could conceivably require separate retail prices for each channel offered, thereby thwarting any nationwide advertising campaign featuring prices. According to Insight, local marketing efforts would be similarly constrained, given the inherent difficulties in effectively establishing a public awareness of the hundreds of separate price points that might be necessitated by a la carte offerings.[137]

Before actually offering an a la carte service, DirecTV states it would have to develop a potentially complicated and confusing set of rules for administering the service. DirecTV states that it currently subsidizes set-top boxes in order to attract new subscribers, and recoups some of that revenue through the sale of programming. It states it would need to calibrate equipment subsidies with the choice of programming by, for example, offering different levels of subsidies depending on the value of programming chosen by an a la carte subscriber. This would greatly complicate, if not preclude, national advertising of rates and special offers for DirecTV's services.[138]

Charter asserts that an a la carte regime ultimately would disappoint consumers.[139] It states that the typical cable customer likely would see an overall rate increase, and the potential for savings is quite small. Confronted with that disappointing result, Charter believes these consumers will call for new regulatory restrictions on package discounting, so as to make the a la carte exercise more meaningful. It states that consumers interested in aggressively pursuing an a la carte option are likely to protest against any restraints on its exercise. According to Charter, the Commission's rate regulation rules, for example, allow cable operators to "establish a higher charge for [subscription] changes ...for a subscriber changing service tiers more than two times in a twelve month period..."[140] Although this regulation has sparked little controversy to date, Charter believes that it surely would aggravate consumers otherwise being encouraged to exercise the a la carte option. They are likely to call for a prohibition on "penalty" charges for frequent service changes. In the end, a host of new regulations might be crafted, yet they probably would leave most consumers less satisfied than they are today.

c. Conceptual Impediments

The issue of mandatory themed tiers was raised for comment throughout the *PN*.[141] Under this scenario, similar services would be required to be sold together for the subscriber's convenience. Some examples of this approach include family tiers, sports tiers, and foreign language tiers. The Sports

[136] *Id.*

[137] Insight Comments at 19.

[138] DirecTV Comments at 8.

[139] Charter Comments at 14-15.

[140] 47 C.F.R. § 76.980(d).

[141] *See* 19 FCC Rcd at 9291-9294.

Leagues' comments exemplify the difficulties in establishing themed tiers. They state that sports programming is programming that can be viewed by the entire family, and would fit well within a "family tier." The inclusion or exclusion of sports programming networks from a "family tier" would raise important questions about exactly how a "family tier" should be defined. Similarly, there is a substantial question over what would be included in a "sports tier." Many of the Professional and Collegiate Sports make their programming available on general entertainment networks such as TBS, TNT and FX. In fact, as many or more Major League Baseball game telecasts are available to consumers on general entertainment services such as Superstation WGN and TBS than are typically available on a regional sports network. Indeed, an even more fundamental question is raised about who would define such tiers – either Congress by law, the Commission by regulation, or the MVPDs themselves.[142]

d. Legal Impediments

This section examines constitutional precedent and statutory prohibitions that may prevent the implementation of an a la carte requirement.

First Amendment. The Supreme Court has held that cable operators are speakers protected by the free speech and press provisions of the First Amendment to the Constitution.[143] Cable operators invoke their First Amendment rights by exercising editorial discretion over their programming choices for their cable systems.[144] In determining the appropriate level of First Amendment scrutiny that a court would use in reviewing any regulation, the first determination is whether the restriction on speech is content-based or content-neutral. Content-based regulations are subject to strict scrutiny and are presumptively invalid. A content-based regulation can survive First Amendment scrutiny only if it: (1) promotes a compelling government interest and (2) employs the least restrictive means to further that interest.[145]

Content-neutral regulations that impose an incidental burden on speech are subject to intermediate scrutiny and can survive a First Amendment challenge only if: (1) the regulation serves an important or substantial government interest, (2) the interest is not related to the suppression of free expression, and (3) the regulation does not substantially burden more speech than is necessary to further the government's legitimate interest.[146] A regulation affecting speech is considered content-neutral if it does not favor any one idea, viewpoint, or message.[147] Content neutral regulations need not be the least restrictive means to advance the government's interest. In other words, a content-neutral regulation is not invalid under the First Amendment simply because there is some imaginable alternative that might be less burdensome on speech. For purposes of intermediate scrutiny, the government must do more than simply

[142] Sports Leagues Comments at 12-13.

[143] "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S.C.A. Const. Amend. 1.

[144] *See Turner I*, 512 U.S. 622, 636 (1994), *citing, Leather v. Medlock*, 499 U.S. 439, 444 (1991); *Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488, 494 (1986).

[145] *See, e.g., Sable Communications v. FCC*, 492 U.S. 115, 126 (1989).

[146] *See United States v. O'Brien*, 391 U.S. 367, 377 (1968).

[147] *See Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989); *R.A.V. v. St. Paul*, 505 U.S. 377, 382-83 (1992).

posit existence of the "disease" sought to be cured, it must demonstrate that recited harms are real, not merely conjectural, and that regulation will in fact alleviate these harms in a direct and material way.[148]

A less heightened level of scrutiny, rational basis, may apply if: (1) the law or regulation is of general applicability, such as an antitrust law;[149] or (2) the underlying medium used to transmit the speech that is affected by the law or regulation is subject to certain physical limitations similar to the broadcasting spectrum, and the regulation serves to enhance or promote and not restrict the freedom of speech.[150] Rational basis scrutiny requires that the law or regulation be reasonably related to the goal or purpose that it is designed to further or achieve.[151]

Turner argues that a government-imposed a la carte requirement would infringe upon its First Amendment rights. It states that such a requirement would interfere with its right to reach its audience in the manner in which it would choose to do so. Turner also argues that a government-mandated a la carte directive would impinge upon cable operators' and other MVPDs' editorial discretion in packaging programming; and it would be akin to a government directive that *USA Today* must sell its News, Sports, Life, and Business sections separately.[152] Courtroom Television argues that mandatory a la carte inherently implicates First Amendment issues because "liberty of circulation" is constitutionally protected.[153] Regulatory measures that would undermine programmers' contractual guarantees to reach as many subscribers as possible would be particularly problematic because "without the circulation, the publication would be of little value."[154] It states that such constitutional concerns are not lessened by the fact that the restrictions primarily affect the profitability of network distribution.[155]

Several commenters believe that a la carte regulation is akin to content-based regulation and, therefore, subject to strict scrutiny. Joint Programmers argue that laws or regulations that attempt to re-shape the distribution of niche programming would have an enormous impact on the content and format of the programming itself. They state that the issues raised by Congress and the Commission entail far more than advertising revenue and license fees because the economic and creative elements of television

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148 *Turner I*, 512 U.S. at 664, *citing Quincy*, 768 F.2d at 1455; *Edenfield v. Fane*, 507 U.S. 761, 770-71 (1993).

149 *See Turner I*, 512 U.S. at 640-41, *citing Cohen v. Cowles Media Co.*, 501 U.S. 663, 670 (1991).

150 *See id.*, 512 U.S. at 637-40, *citing Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 388 (1969) (subjecting regulation imposed on broadcasters to rational basis scrutiny in order to allow competing speakers to be heard (signal interference) and because of the limited amount of spectrum available for broadcasting (spectrum scarcity)). One court has extended the *Red Lion* rationale to DBS, while another has declined to extend this lower level of First Amendment scrutiny to the satellite industry. *Compare Time Warner Entertainment Co, L.P. v. FCC*, 93 F.3d 957, 973-977 (D.C. Cir. 1996) (concluding that DBS technology is subject to similar physical limitations as broadcast technology and therefore should be subject to the same rational basis level of scrutiny as has been applied to the traditional broadcast media); *with SBCA*, 275 F.3d at 357 (concluding that intermediate scrutiny should apply in the context of determining the constitutionality of Section 338 of the Act).

151 *See, e.g., Glickman v. Wileman Brothers & Elliott, Inc.*, 521 U.S. 457, 496 (1997); *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955); *Railway Express Agency, Inc. v. New York*, 336 U.S. 106 (1949).

152 Turner Comments at 9-10.

153 Courtroom Television Comments at 35-36, *citing Rossignol v. Voorhaar*, 316 F.3d 516, 522 (4th Cir. 2003).

154 *Id.*, *citing Lovell v. Griffin*, 303 U.S. 444, 452 (1938).

155 *Id.*, *citing City of Lakewood v. Plain Dealer Publishing Co.*, 486 U.S. 750, 756 n.5 (1986).

programming cannot be separated.[156] Courtroom Television asserts that advocacy groups interested in restricting programming they find objectionable, like Parents Television Council, have lobbied the Commission and Congress for measures to promote consumer purchases of video programming on an a la carte basis, mainly to control content.[157]

In particular, commenters have directed their strict scrutiny attack on mandatory themed tiers. Viacom argues that government action that would require programming to be packaged to consumers based on its program content and themes would be manifestly "content-based." Such regulations either would impose upon MVPDs and programmers governmentally-predetermined conclusions about what programming does or does not fit under specific, and potentially highly subjective, content-based categories—such as "family friendly"—or would force private entities to make such judgments. Viacom states that in either case, the restrictions automatically would be defined by the content of the speech in question.[158]

Courtroom Television argues that an a la carte mandate would not be the least restrictive means of achieving any of the interests the government might proffer. With respect to economic motivations, *i.e.*, keeping MVPD rates or the levels at which they rise within a range that consumers would find acceptable, the government could take additional steps to foster competition among cable operators either by overbuilders or other facilities-based competitors, in addition to DBS providers. According to Courtroom Television, the fact that Congress and the Commission have been allowed to regulate cable rates in the past does not support the conclusion that the government has an interest sufficient to dictate the way in which programming must be delivered to subscribers in order to lower costs or create more choice. Nor would an interest in combating indecency necessarily justify a la carte rules. According to Courtroom Television, an abstract interest in lowering individual cable bills or creating more choice, without more, does not establish the required governmental interest.[159]

Commenters further argue that a la carte regulation, of any type, would fail under intermediate scrutiny. According to Turner, in upholding the Act's mandatory carriage provisions in *Turner*, a divided Supreme Court permitted the limited infringement of MVPDs' First Amendment rights to advance a significant, Congressionally-documented governmental interest.[160] But in connection with a la carte, no government interest can be articulated and no factual record marshaled to satisfy First Amendment standards. Turner states that the government's burden cannot be "satisfied by mere speculation and conjecture," nor by "anecdotal evidence and educated guesses."[161] Here, core First Amendment values of diversity of speech will be harmed, while no offsetting benefit to consumers will be advanced.[162]

NCTA argues that even if the government did have an important interest in enabling customers to lower their bills and keep out unwanted programming by purchasing only those program networks that

[156] Joint Programmers Comments at 10.

[157] A&E Comments at 38-39.

[158] Viacom Comments at 31-32.

[159] Courtroom Television Comments at 41, 43-44.

[160] Turner Comments at 9, *citing Turner II*, 520 U.S. at 193.

[161] *Id.*, *citing Edenfield*, 507 U.S. at 770; *Rubin v. Coors Brewing Co.*, 514 U.S. 476, 490 (1995).

[162] Turner Comments at 9.

they wanted, an a la carte requirement would still be unconstitutional. An a la carte requirement would not enable consumers to watch only what they want at lower prices. It would give consumers the "option" of paying more than they pay today to purchase fewer networks than they watch regularly today. And even if consumers were willing to pay more than they pay today in order to keep certain unwanted programming from reaching their homes, there are already technical alternatives to achieve this result with less intrusion on editorial discretion and protected speech.[163] Viacom adds that mandating the unbundling of program services to subscribers would greatly disrupt the current marketplace and jeopardize many of the efficiencies and public interest benefits promoted by the current system. According to Viacom, this disruption would not be counterbalanced by advancing any important government interest, and certainly would not alleviate any public interest harms in a direct and material way.[164]

Fifth Amendment. The Fifth Amendment prohibits the federal government from depriving any person of "liberty...without due process of law." The Due Process Clause requires the government to provide equal protection of the laws to people similarly situated.[165] A law is subject to strict scrutiny if it infringes on a fundamental right, such as free speech, disparately among certain classes of citizens.[166] In order to pass constitutional muster, the discriminatory law must serve a compelling governmental interest and be necessary to achieve that interest.[167]

According to Joint Programmers, an a la carte mandate presumably would apply to a distinct class, niche networks, and not to broadcast and premium networks, despite the fact that all provide television programming to the public primarily over MVPD platforms. Joint programmers argue that a law that creates a distinct class of persons and regulates those person's fundamental (*e.g.*, First Amendment) rights, will be upheld only if it is necessary to promote a compelling governmental interest. They state that an a la carte mandate would not survive this analysis. Joint Programmers question how Congress could conceivably justify expressly granting broadcast networks the right to dictate their manner of distribution on MVPDs' platforms (*i.e.*, through must carry or retransmission consent), while expressly denying that same right to niche networks.[168]

Joint Programmers argue that the Takings Clause of the Fifth Amendment is also implicated in the debate on a la carte. The relevant portion of the Fifth Amendment provides: ". . . nor shall private property be taken for public use, without just compensation."[169] A physical occupation of property by the government is referred to as a "*per se*" taking.[170] If the occupation falls short of actual physical occupation, it is considered a non-possessory or "regulatory" taking under a balancing test established by

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[163] NCTA Comments at 14-15.

[164] Viacom Comments at 33.

[165] *City of Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432, 439 (1985).

[166] *Shapiro v. Thompson,* 394 U.S. 618, 634 (1969).

[167] *Id.* at 637.

[168] Joint Programmers Comments at 75-76.

[169] U.S.C.A. Const. Amend. 5.

[170] *See, e.g., Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 442-43 (1982).

the Supreme Court in its *Penn Central* decision.[171] The *Penn Central* decision enumerated several factors to be considered when determining whether a government action is a regulatory taking: (1) the economic impact of the regulatory requirement on the claimant; (2) the extent of interference with the claimant's investment-backed expectations; and (3) the character of the government action.[172]

Joint Programmers state that the Supreme Court has consistently recognized that, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking."[173] In the context of an a la carte mandate, Joint Programmers argue that this analysis is straight-forward: many niche networks cannot, and will not, exist if they are forced to be distributed a la carte. Even those networks that manage to survive would suffer a fundamental change to their current business plans which will have a devastating economic impact. Joint Programmers conclude that an a la carte mandate would impair the niche networks' "reasonable investment backed expectations," in violation of the Fifth Amendment's Takings Clause.[174]

Statutory Issues. Federal and local regulation of cable operators' carriage and service obligations are limited by certain provisions of the Act. For example, under Section 621, a cable system cannot be subject to regulation as a common carrier or utility by reason of providing any cable service.[175] Moreover, any franchising authority may not regulate the services, facilities, and equipment provided by a cable operator except to the extent consistent with Title VI.[176] Furthermore, under Section 624, any Federal agency, State, or franchising authority may not impose requirements regarding the provision or content of cable services, except as expressly provided in Title VI.[177]

The Commission may, at times, assert its general jurisdictional grant if the subject of the regulation and the assertion of jurisdiction is "reasonably ancillary to the effective performance of [the FCC's] various responsibilities" under Title I.[178] In order to satisfy this ancillary jurisdiction burden, the Commission must rely upon Section 1 of the Act, which states that the Commission's basic purpose is "to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[179]

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[171] *Penn Central Transportation Company v. City of New York*, 438 U.S. 104, 124 (1978) ("*Penn Central*").

[172] *Id.*

[173] *See Bernier v. Bernier*, 176 B.R. 976, 989 (D. Ct. 1995) (quoting *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922)).

[174] Joint Programmers Comments at 75-76, *citing Penn Central,* 438 U.S. 105 ("a state statute that substantially furthers important public policies may so frustrate distinct investment-backed expectations as to constitute a 'taking'").

[175] 47 U.S.C. § 541(c).

[176] 47 U.S.C. § 544(a).

[177] 47 U.S.C. § 544(f)(1).

[178] *See United States v. Southwestern Cable Co.*, 392 U.S. 157, 177-78 (1968).

[179] *See* 47 U.S.C. § 151; 47 U.S.C. § 152.

The Supreme Court's decision in *U.S. v. Southwestern Cable*[180] is often cited as authority for the Commission to exercise ancillary jurisdiction over cable operators, apart from explicit statutory mandates. In that case, the Court found that the Commission had the authority to restrict the expansion of cable television systems because, under the Act, the Commission has jurisdiction over all interstate communication by wire or radio under Title I of the Act. The Court found that the Act restricted the Commission's authority to that "reasonably ancillary to the effective performance of its various responsibilities for regulation of television broadcasting."[181]

Disney was the only commenter to provide an in-depth statutory authority analysis in this proceeding. Disney argues that when Congress intended to give the Commission authority over a cable-related issue, such as the mandatory carriage of local television broadcast stations, it did so expressly. Thus, if Congress wanted to grant the Commission authority to require a la carte, it would have done so expressly. Absent express jurisdiction, Disney argues that the exercise of ancillary jurisdiction with respect to cable matters is a particularly tenuous proposition given the express reservation of jurisdiction contained in Section 624(f) of the Act. It argues that to require a cable operator to offer certain cable channels on an a la carte basis is a "requirement regarding the provision or content of cable services" in violation of Section 624(f).[182]

Disney further argues that reliance upon Section 1 for ancillary jurisdiction to regulate a la carte would be misplaced because "Section 1 merely authorizes the agency to ensure that all people of the United States, without discrimination, have access to wire and radio communication transmissions." According to Disney, any potential a la carte regulations would govern the manner in which cable operators provide programming and the rates they charge for such programming; a la carte regulations would not expand the reach of cable service to more Americans. Disney adds that ancillary jurisdiction over a la carte also would not be "reasonably ancillary" because any a la carte regulations would impact content and the Commission must have express jurisdiction to regulate content.[183]

3. Consequences

This section discusses the likely impact an a la carte requirement would have on MVPDs and program networks.

a. Retail Rates

A la carte regulation will likely increase operational expenses for MVPDs in three main areas: (1) equipment and infrastructure; (2) customer service operations; and (3) billing and back office support. A large percentage of these increased costs are likely to be passed on to subscribers causing an increase in residential retail MVPD rates.

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[180] 392 U.S. 157 (1968).

[181] *Id.* at 177. While this case has not been explicitly overturned by the Court, the enactment of Title VI by Congress in 1984, which included Section 621(c) as well as 624(f), post-dates this decision and could be interpreted as legislatively vacating the Court's findings and conclusions in *Southwestern Cable*. The Commission's Title I authority was recent subject of litigation. Specifically, the Commission's video description rules were vacated on the ground that they constituted a "direct regulation of program content" and Section 1 does not "authorize the FCC to regulate program content." *See Motion Picture Ass'n of America v. FCC*, 309 F. 3d 796,803-05 (D.C. Cir. 2002) ("*MPAA*").

[182] Disney Comments at 8-12.

[183] *Id.* at 11, *citing MPAA*, 309 F.3d at 805.

Equipment Costs. NCTA states that under mandatory a la carte, all customers that purchase services on that basis must become digital customers with digital boxes on all television sets. Under that scenario, if customers purchased only those services that they regularly watch, NCTA estimates that the average cable subscriber's bill would increase by 22 percent. To pay no more than they pay today, a la carte subscribers would have to limit their selection to no more than six cable networks.[184]

NCTA estimates that the average monthly lease cost for addressable set top boxes is $4.87. Today, more than half of all consumer television sets connected to cable do not have set top boxes. The average American home has 2.5 television sets. Thus, moving to an a la carte or tiered system would immediately add an average of $12.00 per month in cost for each home without set top boxes before subscribers even begin to make program selections. Indeed, Insight does not foresee any scenario, whether by company marketing or due to a shift in regulation or law, that would rapidly change these customers' preferences in this regard. As such, any a la carte requirement that forces subscribers to install (and pay for) unwanted set-top boxes is likely to cause considerable frustration, dissatisfaction and even termination of cable service by existing customers.[185]

Smaller Operators and RTCs state that the technical "solution" of digitizing all channels would come at tremendous expense to cable operators and their customers. Indeed, for smaller operators, the impact on costs would be particularly daunting, given the smaller base of customers over which this expense can be spread. For example, at the system level, cable operators would need to digitize the analog channels that had been previously trapped or carried "in the clear," costing thousands of dollars per channel.[186] Moreover, this cost does not include any additional equipment needed for distributing the signals over the cable system, as well as the additional space, electric power and heating and air conditioning that might be needed to accommodate this equipment.[187] ACA states that the technology cost alone for any cable system to convert an analog line up to digital and offer a la carte exceeds $285,000. This includes costs from set top boxes, billing system changes, and other sources.[188] RTCs argue that such costs would exert substantial upward pressure on consumer rates, a result that is directly contrary to one of the goals of a la carte proponents.[189]

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[184] NCTA Comments at 30.

[185] *See* Insight Comments at 11-12; Charter Comments at 10. Insight states that approximately 66.5 percent of its 1.4 million customers, or a total of 931,000 do not have digital set-top boxes today. Using NCTA's estimate of approximately 2.5 television sets per household, Insight states that these customers would require approximately 2,327,500 set-top boxes. And even the 469,000 Insight customers currently equipped with digital boxes probably have at least one set in their home used to receive analog expanded basic without a set-top box, bringing the total number of boxes required to 2,796,500. Given Insight's cost of approximately $200 per set-top box, conversion to all digital would require a capital expenditure by Insight of approximately $560 million for set-top boxes alone. NCTA estimates that the industry-wide set-top box costs under this scenario would reach $33.8 billion. Conversion of all expanded basic services from analog to digital would also necessitate significant equipment upgrades at each cable headends. Insight Comments at 13.

[186] RTC Comments at 11-12.

[187] Smaller Operator Comments at 6-7.

[188] ACA Comments at 48-49.

[189] RTC Comments at 11-12.

Insight asserts that encrypted digital transmission of all expanded basic channels would also exacerbate consumer electronics compatibility problems. The Commission's equipment capability rules are designed to ensure that the features of a cable customer's analog reception equipment and TV sets work with cable systems.[190] Moreover, for a small number of operators that scramble the expanded basic tier, the navigation devices rules have prompted them to duplicate the analog tier channels in the digital tier. If a la carte becomes an option for subscribers, cable operators would need to retrofit set-top boxes with an analog scrambling function that enables authorizations for each requested analog channel.

CU recognizes the large technical costs associated with an a la carte requirement. It states that the government must prevent the growth of a digital divide, where low-income consumers cannot afford the digital entry price to receive a la carte options. To achieve this, CU appears to advocate digital set-top box price regulation to make equipment "affordable" to all consumers in an a la carte environment.[191] With regard to the costs of supplying set top boxes to multiple sets within a household connected to MVPD service, CU advocates that a single set top box, with a router, will provide an inexpensive consumer solution complementing a la carte.[192] CU/CFA provides scant evidence of the commercial feasibility of this solution. To date, there is no widespread commercial deployment of such technology. In particular, DBS operators have not deployed this technology even though they must provide set-top boxes for each television set on which their subscribers wish to view programming. Rather than deploy this technology, they have chosen to subsidize multiple digital set-top boxes for their customers.

Customer Service Costs. At a typical cable company, customer calls to order service, to report a service problem, or to make a billing inquiry are handled by customer service representatives. ("CSRs"). With a relatively fixed and stable menu of service options, a CSR is typically able to process a subscriber's order (including upgrades or downgrades) by touching a computer screen that displays the available packages.

Many commenters argue that an a la carte mandate, in tandem with the Commission's customer service standards, will likely create havoc at a cable system.[193] Cable operators state that a la carte would exponentially expand the number of service options available to consumers and this, in turn, would

[190] Insight Comments at 14.

[191] CU Comments at 11.

[192] CU/CFA Reply Comments at 27.

[193] Section 632 of the Act requires the Commission to establish standards by which cable operators may fulfill their customer service requirements and provides that "a franchise authority may establish and enforce" cable operator customer service requirements. 47 U.S.C. § 552. It further states that such standards shall include, at a minimum, requirements governing: (1) cable system office hours and telephone availability; (2) installations, outages, and service calls; and (3) communications between the cable operator and the subscriber. 47 U.S.C. § 552(b). With regard to "communications between the cable operator and the subscriber," the standards adopted by the Commission state, in pertinent part, that the cable operator must provide written information on each of the following areas at the time of installation of service, at least annually to all subscribers, and at any time upon request: (1) products and services offered and (2) prices and options for programming services and conditions of subscription to programming and other services. 47 C.F.R. §§ 76.309; 76.1602. The standards also provide that customers will be notified of any changes in rates . . . as soon as possible in writing. Notice must be given to subscribers a minimum of thirty (30) days in advance of such changes if the change is within the control of the cable operator. 47 C.F.R. § 76.1603(b).

increase the complexity and volume of calls handled by CSRs.[194] Moreover, existing CSRs would have to be retrained to handle the increased complexity of a la carte.[195] Customers likely would become frustrated by the length and complexity of an a la carte subscription process. Charter states that it has already witnessed an increase in the average length of its sales calls, as the breadth of its offerings expands. Whereas the average handle time for its sales calls during the first five months of 2002 was just under 5.5 minutes, the average handle time for the first five months of 2004 was just over 6.1 minutes – an 11 percent increase. This trend would accelerate rapidly with the introduction of an a la carte regime.[196] Smaller Operators will face the prospect of having to greatly increase the size of their customer service departments. According to Smaller Operators, these costs are unaffordable.[197]

Billing Costs. In order to implement a la carte, most, if not all, cable operators would also need to make substantial changes, at considerable expense, in their ordering and billing systems.[198] Smaller operators state that even if a cable operator allowed subscribers to select a set number of channels from a menu of options at a flat rate – a highly unlikely scenario considering the programming cost differences among various channels – the operator still would need to adapt its billing mechanisms to track each customer's particular selections so as to be able to report subscriber totals to the programmers on a per channel basis.[199]

Commenters assert that an a la carte mandate, in tandem with the Commission's billing requirements, would likely create severe problems for both cable operators and their customers.[200] Insight asserts that imposition of mandatory a la carte would make it "virtually impossible" to satisfy the Commission's billing requirements. For an a la carte customer, the typical bill could balloon to several pages with itemized listings of each channel received and the associated fees. According to Insight, cable bills would no longer be "clear, concise and understandable," but rather would become confusing and

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[194] Comcast, for example, states that a typical customer call today lasts about five minutes and costs the company $5 to $7.00. With a la carte, Comcast estimates that the length and cost could double. Comcast Comments at 34-35.

[195] Insight Comments at 20; DirecTV Comments at 6-7.

[196] Charter Comments at 12.

[197] Smaller Operators Comments at 9.

[198] Comcast Comments at 36-37 (billing system would have to be completely overhauled to handle increased complexity).

[199] Smaller Operators Comments at 8. One smaller cable operator, which serves fewer than 9,000 total customers, estimates that the billing software changes needed to accommodate a la carte would cost approximately $1,200 more per month. *Id.* at 9.

[200] The Commission's customer service guidelines require cable billing statements to be clear, concise and understandable, with full itemization of services and charges. 47 C.F.R. § 76.1619. The rules require that bills should indicate charges for basic and premium service, any equipment charges, and a summary of all activity during the billing period, including optional charges, rebates and credits. Cable operators should respond to written complaints about billing matters within 30 days. *Id.* at § 76.1619(b). Refunds must be issued no later than either the customer's next billing cycle or 30 days following resolution of the request, whichever is earlier, or upon the return of equipment when service is terminated. Credits must be issued no later than the billing cycle following the determination that a credit is warranted.

unwieldy. Paper and postage costs would skyrocket. Moreover, billing systems and software would require substantial overhaul, if not total replacement, to handle a la carte.[201]

Insight further states that an a la carte mandate would inevitably lead to a dramatic increase in billing disputes. Currently, there are billing issues associated with service level upgrades and downgrades. Cable subscribers are billed in advance, so when the customer elects to downgrade service, it is relatively simple to provide a pro rata refund covering the portion of the month after the downgrade. Insight asserts that an a la carte approach would likely require "wholesale changes" in this process. Insight and DirecTV also believe that some subscribers might seek to "game" an a la carte system by subscribing to a service only when a particular program is scheduled, such as a live sporting event, and then cancel the service the next day.[202] Commenters note that MVPDs might be forced to impose 30-day minimum charges or downgrade fees in response to such practices. According to Insight, the disputes engendered by the complexity of a la carte billing statements are also likely to increase the incidence of uncollectible charges or outright cancellation of service, which again diminishes the cable operator's revenue and results in higher costs for all remaining customers.

Competition. As a general matter, the costs associated with implementing an a la carte requirement would present logistical and financial obstacles for smaller cable operators. While some of these problems also will confront larger cable operators, Smaller Operators state that they operate smaller systems in less densely populated areas that require construction and maintenance of more widespread and expensive facilities on a per-customer basis. Smaller operators state that they commonly have more limited (and more costly) options when it comes to obtaining capital to support investment in their operations and are at a greater disadvantage than larger operators when it comes to competing against the cable industry's primary competitors, DirecTV and EchoStar.[203] If some operators exit the market, consumers may have less choice between competing MVPD services.

b. Program Network Rates

This section discusses a la carte's impact on the existing program network business model. The section examines three key areas of program network revenue and expenses: (1) advertising income; (2) program license fees; and (3) marketing costs.

Advertising Revenues. The business model of virtually every program network, barring certain premium services as discussed above, is a dual revenue stream: advertising revenues and license fees paid by MVPDs for the right to carry the network's programming. On average, a network's revenues are split roughly 50-50 between advertising and license fees. Both streams of revenue are essential to the survival of new and specialized networks because neither is sufficient standing alone, and both revenue streams are tied directly to the network's distribution level – *i.e.*, the total number of subscribers who can view the network.[204]

There are generally two types of advertising time sold on cable program services: network advertising and spot advertising. According to Comcast, network advertising is sold by the program

[201] Insight Comments at 21-22.

[202] *Id.* at 22; DirecTV Comments at 8.

[203] Smaller Operators Comments at 5.

[204] Joint Programmers Comments at 21.

network to national advertisers and generally represents about 50 percent of a service's total revenue.[205] Program networkk's typically have 12-14 minutes of advertising time to sell per hour. Spot advertising is sold by cable operators to local and regional advertisers and represents a relatively small part of an operator's total revenue. As part of their agreement to carry a service, operators generally negotiate for two minutes of spot advertising time per hour (referred to as "ad avails"). The revenue generated by the sale of spot advertising goes to the cable operator, so it does not directly affect a program network's revenues.

The revenue a program network can derive from network advertising is based on the rate the service can charge advertisers, which, in turn, depends on several variables, including actual viewers of the service (referred to as "reach"), potential viewers of the service (*i.e.*, subscribers), the number (or "frequency") of impressions an ad makes, the volume of ad time purchased, and the duration of the ad. The most important of these variables are actual viewers and potential viewers.[206]

Actual viewers are measured by Nielsen Media Research ("Nielsen") and are reported according to a share of viewers in the aggregate of all DMAs. Nielsen ratings are a critical variable in determining how much an ad is worth, and therefore, how much revenue a program network derives from selling ad time. However, Nielsen only provides ratings for 59 of the over 300 national program networks.[207] Thus, many program networks, especially niche, new, or digital networks, must rely almost exclusively on potential viewers as the primary variable for determining the price they can charge for advertising.

Potential viewers are based on the number of households to which a program network is distributed. Many advertisers seek "rotation" and value new impressions more highly than repetitive impressions -- they prefer their ad to be seen fewer times by more potential purchasers of their products than repeatedly by a smaller number of potential purchasers. According to Comcast, advertising time on a network offered on a tier is generally worth more than the same advertising time on a network offered a la carte. Moreover, even if all the regular viewers of a network offered in a tier were to subscribe to the network if it was offered a la carte, the network would still suffer a reduction in advertising revenues because it would lose "rotation," that is, the ability to reach more potential viewers.[208]

As a matter of general industry practice, program networks forecast advertising revenue under a rather uncomplicated mathematical formula: the product of the number of households in which a program is distributed multiplied by a program's rating equals the number of viewer "impressions." Then, these "impressions" are multiplied on a cost per thousand basis to arrive at a unit cost for a 30-second spot. Obviously, the greater the distribution, the higher the expected advertising revenue a program network can achieve.[209] To put it more simply, the rates that advertisers pay to be seen on program networks vary based on the size of a program's audience. The greater the number of homes in which a channel is

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[205] Comcast Comments at 20.

[206] *Id.* at 21.

[207] Cabletelevision Advertising Bureau, *CAB Research, National Market Facts, Cable Penetration, at* http://www.onetvworld.org/.

[208] Comcast Comments at 22-23.

[209] Scripps Comments at 13.

carried, the more likely that any given program can attract a substantial number of viewers, which in turn generates increased advertising revenue.[210]

It is commonly-accepted that channels that enjoy wider coverage are deemed most desirable by advertisers. As reach increases, advertising revenues increase at roughly the same pace but only for networks that reach fewer than 50-60 million subscribers. However, once a cable network's circulation reaches approximately 70-80 million subscribers, this proportionate relationship breaks down and there is a major jump in advertising revenues. This jump is attributed to a number of factors. The first factor is that as reach increases, the statistical reliability of ratings information (on which advertising purchases are based) increases significantly and therefore the advertising on these networks becomes more reliable and more valuable. Secondly, advertisers prefer (and will pay a premium for) broad reach and will pay more for an advertisement that will reach 1 million viewers at once than one that will reach 500,000 viewers at two different times.[211]

Program ratings, as provided by Nielsen, are a critical measure of the viability of a program network. Ratings information is critical to advertising sales in the "Upfront Market," which typically accounts for the sale of the majority of a program network's advertising inventory. Advertising sales in the "Upfront Market" are built on subscriber and ratings projections 12 to 15 months into the future. Consistent subscriber levels and rating trends enable a program network to provide the estimates necessary to sell advertising time in the upfront market. If actual viewership is less than the guarantee, "upfront" agreements call for adjustments in the form of more inventory (referred to as "Audience Deficiency Units" or "ADUs") on the back-end. The inability to predict distribution levels over time would adversely affect a program network's ability to sell advertising. Reliable estimates of distribution and network ratings months into the future are critical to the sale of national advertising time. Thus, distribution on broad, popular service tiers provides the necessary subscriber counts to predict ratings more accurately, which helps a network participate in successful upfront sales. Oxygen, and other program networks, assert that a la carte carriage is likely to lead to significantly greater monthly churn in subscribers making it almost impossible to estimate audience size far enough in advance to be able to take part in a successful upfront.[212]

How many subscribers a program network needs to become viable and remain viable for ratings and advertising purposes is the subject of some discussion in this proceeding. For example, CU notes that program services can be, and are, viable even if they reach fewer than 15 million United States MVPD subscribers.[213] Hallmark states that Nielsen may rate a program network with 20 million subscribers, but notes that few advertisers will buy advertising at that level and the cost per thousands generally are not competitive. It remarks that advertisers are interested in such networks only if they are emerging, *i.e.* their distribution is steadily and rapidly increasing.[214] GSN states that a network needs at least 25 million subscribers just to be included in the Nielsen ratings, and, at that level, any ratings data are likely to be

[210] Fox Cable Comments at 6.

[211] Disney Comments at 13-14.

[212] Oxygen Comments at 5; MBC Comments at 7-8.

[213] CU\CFA Reply Comments at 22-23. The Commission has estimated that a program network is viable with between 15-20 million subscribers. *See Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19098, 19115 (1999).

[214] Hallmark Comments at 6.

subsumed within Nielsen's margin of error; while a few advertisers might be willing to take a chance on a new program network, it is all but impossible to sell meaningful national advertising at that subscribership level.[215]

Joint Programmers state that a national niche network needs to achieve a threshold level of at least 30 million to 40 million subscribers in order to be considered as a possible advertising vehicle for national advertising. A&E states that to attract sufficient advertising revenue to afford to pay for and provide a meaningful quantity of original programming, a network must reach approximately sixty million subscribers.[216] Viacom, however, states that a network usually needs a subscriber base of approximately 50 million, which represents about half of the country's households, to serve as effective advertising vehicles.[217]

Joint programmers note that some niche networks, depending on their business plan, programming model and investment, may require more or less distribution. Furthermore, regional sports networks do not need to reach tens of millions of subscribers to be successful. Rather, their benchmark is based on the size of the regional market they serve. Nevertheless, even within a much smaller regional base of households, the regional networks still require widespread distribution across the region.[218]

Advertising revenue. The majority of commenters stated that an a la carte regime would undermine the ability of program networks to garner the advertising revenue needed to remain viable.[219] Most program networks, especially newer, smaller, and independent entities, agree that the loss of advertising revenues resulting from a la carte carriage would be real, immediate, and very substantial. They argue that the proposition is simple: a la carte would decrease viewership, which, in turn, would decrease advertising revenues, which would lead to higher license fees to recoup the loss in revenue, which would likely result in less carriage on cable and satellite, thus resulting in the demise of certain program networks.

Commenters submitted too many examples of harm to report in detail, but Hallmark's assessment is typical of the comments received. Hallmark states that a 20 percent increase in its subscribership and improved ratings is likely to yield more than a 70 percent increase in advertising revenues. It asserts that subscriber losses would be very substantial under a la carte as even a modest decrease in subscribers would cause a much larger percentage decrease in advertising revenues. Hallmark states that, typically, annual advertising revenues range from $1.00 to $6.00 per subscriber for program networks, depending upon programming genre, target audience, and brand identity. If a program network with 70 million

[215] GSN Comments at 4.

[216] A&E Comments at 13-14.

[217] Viacom Comments at 8-9.

[218] Joint Programmers Comments at 21-22 n.54.

[219] *See* A&E Comments at iii-v; Bloomberg Comments at 2-3; Courtroom Television Comments at iii-v; C-SPAN Comments at 1-5; Discovery Comments at iii-v; Eternal Word Television Networks Comments at 2-6; Fox Cable Comments at i-iv; GSN Comments at 2-8; Hallmark Comments at 2-12; International Channel Comments at 1; Joint Programmers Comments at i-v ; LAtv Holdings Comments at 1-2 ; LeSEA Comments at 4-7; Lifetime Comments at 3-8; MBC Comments at 1-9; NBC Universal, Inc. Comments at 1-8; Oxygen Comments at 2-8; Scripps Comments at 1-5; Starz Encore Comments at 2-6; TelAlaska, Inc. Comments at 2-3; Turner Comments at 1-2; TV One Comments at 1-3; Univision Comments at i ; Viacom Comments at 1-3; Disney Comments at 2-3; and Weather Channel Comments at 1-2.

subscribers and $3.00 per subscriber in advertising revenues lost only 20 percent of its subscriber base due to a la carte, it would lose $42 million in advertising revenues in the first year alone. A greater initial subscriber loss or subsequent erosion of subscribers would only make the revenue picture bleaker. Hallmark states that lost advertising revenues are only part of the equation as there also would be lost subscriber revenues unless license fees were increased.[220]

The sentiments expressed by the program networks are reflected in the expert testimony of witnesses that attended the Commission's a la carte symposium in July 2004. The Commission invited four independent economists to discuss a la carte issues. All four appeared to agree that mandatory la carte would negatively impact advertising revenue. For example, Professor David Waterman asserted that a la carte would have an adverse effect on the non-broadcast advertising market and, consequently, the program network license fee structure.[221] Specifically, advertisers would be inclined to purchase time on broadcast stations rather than program networks sold a la carte because the former outlet can guarantee a much broader audience.[222]

Joint Programmers state that media buyers and advertising agencies seeking to purchase time on behalf of their advertising clients would find buying ads on a la carte niche networks to be too cumbersome and costly. This is because media buyers would have to purchase time on multiple a la carte networks to achieve the same level of viewership as on other, more widely distributed media. As a result, ad agencies and media buyers likely would simply seek out other media that could, with one stop, provide the desired audience reach and "impressions."[223]

At the symposium, Jon Mandel, Co-CEO of Mediacom Worldwide, a firm that purchases advertising time on program networks for large corporations, explained that advertisers look beyond a network's Nielsen ratings, and also consider the number of unique viewers, the measure of which is its average weekly cumulative audience. Mr. Mandel explained that a network's cume directly correlates to its distribution, and concluded that a la carte would reduce a network's distribution, cume and, ultimately, its ad revenues. Advertisers would seek to purchase advertising time on broadcast stations or other media with a bigger audience and would neglect smaller niche programming networks.

Similarly, GSN explains that broadcast stations are guaranteed carriage and viewership through government regulation. As a result, while independent programmers like GSN would lose distribution through mandatory a la carte carriage, broadcasters would be able to assure advertisers that every cable subscriber would have access to their advertisements. The advertising market would be skewed again in favor of broadcasters and their affiliated program networks, just as many program networks are beginning to compete with them for national advertising revenues.[224] International Channel states that "there is no question" that the advertising dollars lost by smaller program networks as a result of their movement to mini-tier or a la carte carriage will flow to the large media conglomerates and broadcast-affiliated programmers.[225]

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[220] Hallmark Comments at 9.

[221] Transcript at 197.

[222] *Id.* at 187.

[223] Joint Programmers at 41.

[224] GSN Comments at 6-7.

[225] International Channel Comments at 8.

Echostar asserts that an examination of the most current trends in the advertising market calls into question one of the fundamental premises of the opponents' argument -- that advertisers absolutely demand the widest possible distribution for their ads. According to Echostar, industry observers have characterized the mass marketing model via media such as television as "fading" and giving way to "a dawning era of micromarketing." Echostar states that the nation's largest product marketers, such as Procter & Gamble Co., Coca-Cola, McDonald's, Unilever Group and Pfizer report a shift in their advertising focus from the "vast anonymous crowd" to "millions of particular consumers." Echostar further states that these advertisers are increasingly seeking to focus their ad expenditures on reaching what they regard as their "prime target audience" in an effort to "spend[] smarter on advertising."[226]

License Fees. License fees paid by MVPDs also are an essential revenue stream for most program networks. License fees usually are established on a fixed-rate "per subscriber" basis that is negotiated as part of the affiliation agreement between the MVPD and the network. As such, this revenue stream is directly contingent upon the number of subscribers to which the programming is distributed. Accordingly, program networks seek distribution on MVPD platforms as part of the most widely-penetrated service tier possible.

Cable operators and program networks agree that a la carte would have a negative effect on license fees. To make up the loss in advertising revenue, a program network will have to increase its license fee, which will, in turn, increase the cost of programming to cable and DBS subscribers. Moreover, not only will the license fee be higher; it will have to be recovered from a smaller number of subscribers, further increasing the cost of the network to those who choose to purchase it. But increasing the per-subscriber cost of a service will, in turn, further reduce the number of subscribers. Whether this trend will lead to an equilibrium price at which there are a sufficient number of buyers to continue to sustain the network or will instead become a downward spiral that destroys the network's viability, will depend on the nature of the demand for each particular network. According to NCTA, it may be that the network will have no choice but to respond to lower advertising revenue and fewer subscribers by reducing the cost, and quality, of its programming. But this reduction in quality is only likely to further diminish the attractiveness of the network and further reduce the number of customers who choose to purchase the network.[227]

Oxygen asserts that in order to compensate for lost ad revenues, it would have to increase its subscriber fees significantly and somehow reduce its costs to survive. Oxygen explains that its largest category of expense is programming costs and, unlike networks affiliated with large media firms, it is not in a position to draw on programming from any affiliates. As a result, cost reductions inevitably would reduce programming expenditures. Oxygen asserts that original programming, which is unfamiliar to consumers, and thus less effective at attracting new viewers in an a la carte environment, would bear the brunt of the expense reduction.[228] Courtroom Television estimates that in a pure a la carte environment it would have to charge customers at least $5.00 per month and maintain at least 85 percent of its current expanded basic carriage in order to remain profitable. Courtroom Television states that such a price is wholly unrealistic, however, since it is expected that only about 0.3 percent of cable subscribers would

[226] Echostar Reply Comments at 3, 5.

[227] NCTA Comments at 8-9.

[228] Oxygen Comments at 7.

purchase the network at this price.[229] Bright House Networks ("BHN") states that because each affected network would most likely be required to increase its license fee to maintain license fee revenue on a neutral basis to offset lower distribution, retail per-channel rates paid by subscribers would almost certainly rise. A cable subscriber opting to maintain the same level of service presently offered on a bundled basis likely would pay a higher retail rate if some or all of those services were offered on an a la carte basis. A consumer choosing to pay the same monthly rate presently being incurred would likely receive fewer services for that same retail rate. BHN asserts that a subscriber choosing to reduce his or her monthly fee would pay more per channel and receive significantly less programming.[230]

To the extent that a la carte service is being considered as a means of reducing consumers' costs by reducing the programming costs that cable system operators face, Univision remarks that offering local broadcast stations on an a la carte basis will not affect the license fees paid by cable providers. It states that, by law, must carry stations receive no payment for cable carriage, and even among stations carried pursuant to retransmission consent agreements, few stations receive cash compensation for permitting carriage. As a result, the cable operator would have no monetary "savings" to pass on to subscribers who decline some or all of their local stations. Application of a la carte to local broadcast stations would therefore accomplish nothing in terms of subscriber savings, but would instead threaten those subscribers' access to local emergency information and limit local program diversity.[231]

Marketing. Most commenters maintain that a la carte would also have a significant negative impact on the marketing practices of program networks. These commenters agree that marketing expenses would substantially increase under a la carte.[232] NCTA states that research suggests the average household regularly watches 17 channels among the total they receive (including broadcast networks). According to NCTA, only 20-30 percent of current subscribers account for up to 60-80 percent of total viewing for most program networks.[233] Absent major program network expenditures on branding and promotion, which do not currently occur, subscribers are unlikely to choose to purchase particular networks that they do not currently watch regularly.

Under the existing tiered model, the first objective for any program network is to obtain distribution from MVPDs. Most advertiser supported program networks employ an affiliate marketing group whose efforts are targeted at their distributors, (i.e. cable operators, DBS, and other MVPDs). They also typically employ a limited number of trainers, whose function is to educate CSRs at the cable system level or DBS call centers about the programming service, so that when questions concerning the service arise, the CSRs will be able to provide informed responses to consumers and effectively sell the programming service. When a programming service is launched on the basic or expanded basic tier, trainers often will work with the CSRs immediately before and coincident with the launch of the service. Because most carriage agreements are for multi-year terms, there often is little need for a program network to devote substantial marketing or training resources to follow up with the cable system once its service is launched on a particular tier, unless the system is rebuilding or re-tiering or the affiliation

[229] Courtroom Television Comments at 29-30.

[230] BHN Comments at 11.

[231] Univision Comments at 8.

[232] *See, e.g.,* Bloomberg Comments at 10-11; C-SPAN Comments at 4-5; GSN Comments at 7-8; Hallmark Comments at 7-8; Joint Programmers Comments at 56-58; Oxygen Comments at 6; Starz Comments at 2-6; TV One Comments at 2; and Disney Comments at 2, 18.

[233] NCTA Comments at 24.

agreement is coming up for renewal. Instead, as the program network gains more distribution, it typically begins to focus more efforts on advertising sales.[234]

In Starz Encore's experience, the marketing work for a program network begins when it obtains a la carte carriage from an MVPD rather than a commitment to carry the service on a broad service tier. Rather than spreading the cost of adding a new service over the entire package to which the service would be added, Starz explains that the MVPD must be able to recoup the cost of adding an a la carte service from that service alone, or from the addition of new subscribers to the system attracted by the new service. Otherwise, there is no economic reason for the MVPD to add the service in the first place. An a la carte program network must be able to demonstrate that it would be a separate profit center for the MVPD rather than "filling out" an existing service package. Consequently, an a la carte program network must devote enormous resources to marketing its service to distributors and to consumers in order to gain and maintain brand recognition and customer demand for the service and cannot rely on the popularity of other services in a tier to drive penetration.[235] Starz asserts that if each and every program network is required to market its service on an a la carte basis, it would be extremely difficult for even established programmers to educate the MVPDs' CSRs about their respective programming services.[236]

Courtroom Television states that the marketing strategies and attendant costs for a stand-alone network are substantially different from the approaches it has followed. For example, an a la carte channel, such as HBO, uses advertising and marketing strategies focusing on consumer awareness so that subscribers know enough about a network to make the affirmative purchasing decision to select and pay for it on a monthly basis. It must then heavily advertise its individual program offerings ("tune-in" advertising) to retain its subscriber base and garner ratings. The monthly "churn" in the premium business is significant and premium services experience high transaction costs of retaining, terminating, and replacing customers each month. As a consequence, stand-alone channels generally have far lower penetration among subscribers than do tiered networks.[237] MBC adds that a la carte networks, like HBO, also must devote substantial resources to "win-back" marketing aimed at convincing subscribers who have cancelled the service to re-subscribe.[238]

Turner states that an important marketing component of its networks is cross-promotion using air time on the networks themselves. Turner asserts that in an a la carte environment, cross-promotion would be less effective and would result in increased promotional and marketing expenses.[239] In contrast, Oxygen states that unlike new program networks "spawned by programming conglomerates", independent program networks have no means to subsidize or cross-promote their service, or to offer consumers the opportunity to view the service (or any if its specific programs) on a sample or trial basis. An independent programmer has no comparable way to subsidize its programming and marketing costs, to make consumers aware of its service, or to drive name recognition. It must rely on its own promotions and "drive-by" viewing or channel surfing. MBC also asserts that it would have a significant disadvantage vis-à-vis programmers affiliated with broadcast networks or large program networks. It states that those networks can use their widely distributed affiliated programming services to let the

[234] Starz Comments at 3.

[235] *Id.* at 3-4.

[236] *Id.* at 6.

[237] Courtroom Television Comments at 24.

[238] MBC Comments at 4.

[239] Turner Comments at 9.

consumer sample their programming and that many such program networks have generated interest in their developing networks by running particular shows on their more popular, established networks.[240] Oxygen and MBC both agree that carriage on a popular tier gives an independent program network the benefits of the distributor's marketing of the tier and offers it the opportunity to promote the service through ads on the other program networks. Absent tiered carriage, an independent program network would have no reasonable means to induce consumers to make the initial purchase decision for the service a la carte or on a themed-tier, sight unseen.[241]

In order to reach the entire potential audience and drive subscription to an a la carte service, MBC asserts that it would have to market nationally, even though its service could not be received in markets where it is not carried by the cable operator serving those markets or by any DBS provider. Even in markets with substantial African-American populations, a significant portion of any money spent on mass media advertising would be wasted because some portion of the audience reached by that advertising inevitably would be served by a distributor who has refused to carry MBC. Thus, even if MBC had the resources, it would "get less bang for each buck" spent on consumer advertising.[242] Joint programmers assert that since channel surfing no longer would be possible, networks would be forced to market their services through magazines, newspapers, radio, billboards, television, bill-stuffers, telemarketing, direct mail, commissioned sales, and local grass roots promotions, all of which are more expensive compared to what niche networks presently need to do to reach potential subscribers.[243]

According to NCTA, most program networks currently spend only 2-6 percent of total net revenues on marketing. NCTA estimates that these expenditures would increase to as much as 20 percent to 30 percent of revenues in an a la carte environment, based on benchmarks of premium networks and consumer packaged goods companies.[244] Program networks provide actual and individualized data on the marketing costs associated with promoting networks to subscribers. For example, Viacom demonstrates, through information obtained from Showtime Networks, which has operated as an a la carte service since its launch in the 1970s, marketing efforts could entail expenditures in the hundreds of millions of dollars per network, per year. With per subscriber marketing costs estimated at $16.90, a network with 25 million subs would incur $300 million in costs each year just to retain the same number of subscribers.[245]

In addition to increased marketing costs, Starz asserts that program networks also would incur increased costs to monitor subscribership and churn in each system. To a large degree, program networks carried on the basic or expanded basic tier currently depend on cable operators to provide accurate subscribership information to support their license fee payments, with limited audit rights that may be available under their affiliation agreements. According to Starz, a la carte would require the programmer

[240] MBC Comments at 5.

[241] Oxygen Comments at 3-4.

[242] MBC Comments at 5.

[243] Joint Programmers Comments at 57.

[244] NCTA Comments at 26.

[245] Viacom Comments at 15. *See also* A&E Comments at 18 (Under a mandatory a la carte system, A&E's promotion costs would be 250 percent of its current costs – a 150 percent increase); Discovery Comments at 10 (Discovery would incur $66.4 million in additional marketing costs under an a la carte mandate).

to monitor fluctuations in its subscriber base to ensure accurate payment of license fees by the cable operator.[246]

Financing. As demonstrated above, mandatory a la carte would alter the advertising revenue/license fee business model upon which all networks are based and could have significant effects on prices and/or quality of all program networks.[247] According to Hallmark, its enterprise was based upon a business plan of widespread distribution by cable and DBS operators on highly-penetrated packages of popular programming services. Shifting advertiser-supported programming services from such tiers or requiring a la carte carriage would effectively nullify its efforts.[248]

Joint Programmers state that a niche network requires a tremendous level of initial capital investment, and a substantial continuous revenue stream to sustain its operations and provide funds for investment in programming. They assert that an a la carte mandate would negatively affect the ability of program networks to obtain capital and force many niche networks into bankruptcy. According to Joint Programmers, the implosion of the competitive local exchange carrier ("CLEC") industry during 2000-2002 provides a recent and vivid image of what can happen to a nascent industry when it no longer has access to capital.[249]

MBC states that developing networks are always in need of financing. Commitments by cable operators and other MVPDs to carry a particular program network on a popular service tier are invaluable in obtaining the financing needed to develop and sustain a program network because they enable the programmer to provide a reasonably accurate estimate of the number of homes that will be reached by the network and to develop budgets and financial projections. Many networks, particularly those affiliated with broadcast networks and cable or DBS operators, obtain pre-launch commitments for carriage on widely distributed tiers, which helps to facilitate investment in the network. In an a la carte environment, it would be impossible for even these networks to obtain reliable distribution estimates in advance of launch, adversely affecting financing opportunities for the network.[250]

Oxygen also believes that financing is essential to the development of any new independent programming service, and carriage commitments are prerequisites to obtaining it. Oxygen states it was able to obtain a pre-launch commitment from Tele-Communications, Inc. (later AT&T Broadband) to carry Oxygen on cable systems serving seven million homes in the first two years of service after launch. The TCI commitment enabled Oxygen to obtain the first round of financing it needed to launch. It also helped Oxygen to obtain carriage commitments from other MVPDs, so that within the first year of its launch, Oxygen had commitments for carriage to more than 20 million homes, which commitments in turn enabled Oxygen to secure additional rounds of financing. According to Oxygen, its experience demonstrates that carriage on a popular service tier, providing assurance of distribution to millions of homes, is essential to obtain the financing necessary to develop and launch an independent program

[246] Starz Comments at 6.

[247] Turner Comments at 6.

[248] Hallmark Channel at 7.

[249] *See* Joint Programmers Comments at 25, 42.

[250] MBC Comments at 7.

network. It states that a la carte carriage commitments from the same MVPDs would not have provided meaningful committed distribution, and financing would have been unavailable.[251]

The advocates on behalf of small businesses ("ASB") state that programmers will suffer a "death spiral...from the diminished base of subscribers from the current business model and the resulting loss of advertisers..."[252] ASB states that current cable offerings "represent a thriving industry that employs thousands of Americans and provides millions of consumers the variety and choice they want." It concludes that mandatory 'a la carte' distribution of program networks would "silence these voices and reduce the new opportunities for developing thriving networks and shows."[253]

Competition. According to Fox Cable, a reduction in the number of programmers because of a la carte would reduce economic competition among networks. It states, for example, that National Geographic competes for audience and advertising share with other family-oriented entertainment networks. National Geographic bargains with MVPDs to be placed in the same neighborhood of the system's programming lineup as the channels with which it competes. If National Geographic were forced off tiers because of a la carte, its competitors would face less competition, which in turn could enable them to raise their own license fees or reduce the quality of their program offerings. Fox Cable states that either way consumers would suffer the consequences. Similarly, networks that now are willing to take on the financial risk of producing content more narrowly targeted at a niche audience may feel compelled to revert to more generic programming in an effort to appeal to a mainstream audience. Alternatively, other networks may pursue an audience willing to pay higher a la carte rates by offering adult-themed content – perhaps even content that some would consider indecent. In short, "competition would be the unwitting victim" of any a la carte policy.[254]

Contracts. An a la carte requirement would likely force the re-negotiation of thousands of affiliation contracts. Courtroom Television asserts that any regulatory intervention requiring a la carte carriage would effectively abrogate long-standing contractual arrangements and override carefully negotiated tier placement provisions, thus depriving those networks of contractual benefits they bargained for and reasonably expected to receive.[255]

Copyright. Joint Programmers assert that a la carte will negatively affect copyright holders. They state that the right of a content creator to specify the manner in which its work is distributed to the public and to profit from its efforts is a fundamental principle of copyright law. It notes that the Supreme Court has found, "[t]he rights conferred by copyright are designed to assure contributors to the store of knowledge a fair return for their labors"[256] and Federal copyright law specifies that owners of copyrighted audiovisual works have "the exclusive right to do and to authorize" others to "display the copyrighted work publicly."[257] Joint programmers state that a la carte mandate would deprive niche

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[251] Oxygen Comments at 2-3.

[252] ASB Comments at 2.

[253] *Id.*

[254] Fox Cable Comments at 9.

[255] Courtroom Television Comments at 22.

[256] *Harper & Row v. Nation Enterprises,* 105 S. Ct. 2218 (1985).

[257] 17 U.S.C. § 106.

networks, who are copyright owners or licensees, of the right to decide how their content is distributed and displayed to the public, and as such, is at odds with fundamental principles of copyright law.[258]

c. Diversity and Program Quality

"It has long been a basic tenet of national communications policy that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public."[259] The Congress, the Commission, and the Courts have all stated that diversity is one of the paramount goals in Federal communications policy.

There was a near universal response from program networks, cable operators, and others, that a la carte regulation, of any type, would harm consumers because the public's interest in program diversity would be threatened. Viacom, for example, states that the imposition of a la carte would result in fewer choices and diminished diversity.[260] EWTN asserts that the movement to an a la carte model will result in the reshaping of MVPD lineups from a model that does an "extremely good job of broadly serving community needs and interests into one that will be merely a contest between channels as to which one can generate the most a la carte revenue."[261] Indeed, a diverse array of interest groups and public officials across America have urged the government to reject a la carte because of its severe impact on diversity.[262]

Consolidation of New and Established Services. Hallmark asserts, *inter alia*, that a la carte would lead to a reduction of diverse "independent" content providers because the economic burdens would be so great that only the large media companies with substantial operating economies would be left to compete.[263] GSN agrees and asserts that the resulting financial pressures would likely yield further consolidation, with the broadcast network conglomerates using their established brands, cross-promotional opportunities, and financial wherewithal to acquire other program networks struggling as a result of conversion to a la carte carriage.[264]

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[258] Joint Programmers Comments at 66.

[259] *Turner I*, 512 U.S. at 663-64 *citing United States v. Midwest Video Corp.*, 406 U.S. 649, 668 n.27 (1972) (plurality opinion) (quoting *Associated Press v. United States*, 326 U.S. 1, 20 (1945)).

[260] Viacom Comments at 27.

[261] EWTN Comments at 6.

[262] *See e.g.,* Women's Alliance Comments at 1; Woodhull Institute Comments at 1; Step Up Comments at 1, Rainbow Push Coalition Comments at 1; National Urban League Comments at 1; Hispanic Federation Comments at 1; National Asian Pacific American Legal Consortium Comments at 1; FFBC Comments at 11; and NCTA Reply Comments at 5. Dozens of elected officials have also written letters to Congress and the Commission detailing the adverse consequences that an a la carte mandate would have on diversity and consumers, generally concluding that such obligations would be a "classic case of a solution that is far worse than any perceived problem." *See, e.g.,* Letter from Harvey C. Johnson, Mayor, Jackson, Mississippi, to Reps. Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004); Letter from Roosevelt F. Dorn, Mayor, Inglewood, California, to Reps. Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004); Letter from Irene H. Brodie, Mayor, Robbins, Illinois, to Reps. Joe Barton and John Dingell, U.S. House of Representatives (July 12, 2004).

[263] Hallmark Comments at 11-12.

[264] GSN Comments at 8.

There is broad agreement that new program networks would suffer the most from a la carte. DirecTV states that because viewers are likely to choose only those channels with which they are already familiar, an a la carte regime would threaten smaller, nascent channels and stymie the development of innovative new channels. The result would be a diminution in programming diversity, as the available choices converge to the formats with the widest general appeal at the expense of niche and specialty programming and their audiences. According to DirecTV, reducing the current depth and breadth of programming to a much more limited and homogenized slate of offerings would be a significant loss to all viewers.[265]

Joint Programmers and Scripps state that an a la carte mandate likely would delay the development of VOD and other new services, some in foreign languages, by depriving niche networks of the resources needed to fund these new opportunities.[266] Bloomberg states that it has been working to introduce interactive television services, such as the Bloomberg Virtual Channel, that allows viewers to access breaking financial information on demand while watching Bloomberg Television or the programming of their choice. It states that this, and other similar products, could not have been developed and introduced under an a la carte regulatory model.[267]

Broadcast Stations and the Basic Service Tier. A broadcast station is a unique kind of program network for purposes of this analysis. Broadcast stations are suppliers of content for distribution by MVPDs, but they also supply video programming directly to those television households that are not MVPD subscribers and to television sets in MVPD households that are not connected to such service. Broadcast stations and networks, like MVPDs and non-broadcast program networks, derive revenue from advertising.

Broadcast stations assert that an a la carte requirement would cripple their business, even though all broadcasters are available over-the-air and are receivable by households with antennas. For example, Univision states that local broadcast stations face a number of economic burdens that competing program networks do not share. Univision explains that, unlike other non-broadcast networks, local broadcast stations have significant distribution costs associated with continuously operating a high-powered transmitter. It states that these distribution costs are doubled during the digital television transition as local stations must pay for tower space and electricity for two duplicative facilities. Univision states that local broadcast stations can only serve a limited geographic area, unlike the nationwide footprint of a program network. Univision also states that a local broadcast station has to survive purely on advertising revenues, whereas a program network has two revenue streams. Univision argues that an a la carte approach would further erode the economic base on which every free, over-the-air broadcast station

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265 DirecTV Comments at 5.

266 Joint Programmers Comments at 74; Scripps Comments at 4.

267 Bloomberg Comments at 7. *See also* Allbritton Reply Comments at 8-9 (stating that NewsChannel 8, a local non-broadcast news network it owns in Washington, D.C., would not be able to survive on an a la carte basis).

depends in order to survive, as local stations could no longer offer potential advertisers access to all local viewers.[268]

CU states that local broadcast stations that serve community needs and interests should be made available to all subscribers, along with national broadcast networks that meet a "public interest" test by providing diverse viewpoints on matters of national and global importance. It adds that locally oriented public, educational and government programming would be adequately funded if the basic service tier is preserved.[269] The Alliance for Community Media ("ACM"), representing PEG providers, asserts that any attempts to break up the basic service tier could seriously jeopardize the existence of public access channels.[270] ACM further asserts that the relegation of local access channels to a themed tier would destroy the ability for every subscriber in the community to receive such channels.[271]

Cablevision is critical of the broadcast signal carriage and the basic service tier requirements, the latter of which it terms "the must buy" provision of Title VI. It argues that these requirements restrict consumer choice, artificially raise consumer costs, and deny cable operators the ability to tailor service packages based on competitive pressures and customer needs.[272] Cablevision states that the basic service tier requirement, along with the broadcast signal carriage regulations, cost each subscriber about $13.00 per month. If they wish to receive any non-broadcast program networks, they must purchase the entire tier of broadcast channels as a condition of access to the cable service they want. Cablevision states that there is no justification for giving broadcast channels a mandatory "pride of place" in a cable operator's line-up through "must buy." Cablevision posits that as cable service has become less a vehicle for improved reception of broadcast signals and more a home to creative and popular programming services, the related requirement that customers purchase broadcast programming as a condition of access to other cable programming services has become an increasing cause of customer dissatisfaction. Moreover, unlike cable, satellite subscribers are not forced to buy broadcast programming as part of their service offering. Rather, they can choose to receive it for a separate fee. Cablevision asserts that this gives satellite an unfair competitive advantage over cable in competing for certain customers.[273]

Positive Effects. Not all parties find that an a la carte mandate would harm diversity. Some believe that a la carte will correct a marketplace infirmity by permitting economic forces to dictate program options. Pioneer, for example, states that many program networks may not be able to stand on their own in the media marketplace. However, this would be the result of a dynamic market where all programming vendors are allowed to introduce their product and where consumer choice ultimately

[268] Univision Comments at 7. National Religious Broadcasters states that without the presence of some basic tier, religious broadcast stations would be irreparably harmed. It posits that while a la carte would ostensibly offer consumers freedom to choose, in the end, their choices could be reduced if the economic model that supports many broadcasters is damaged or destroyed. NRB Comments at 2. Religious Voices in Broadcasting ("RVB") asserts that to exclude broadcast stations from the basic service tier, or to redefine the basic service tier in a manner inconsistent with Section 623, would undercut the broadcast choices necessary to preserve balanced and diverse perspectives. RVB Comments at 5.

[269] CU/CFA Reply Comments at 18.

[270] ACM Comments at 2.

[271] *Id.* at 3.

[272] Cablevision Reply Comments at 2.

[273] *Id.* at 7.

determines the kind of programming the public would like to see.[274] The Urban Broadcasting Company ("UBC") states that it has faced difficulty obtaining carriage deals with MVPDs. It predicts that if consumers are able to purchase minority cable television networks on an a la carte basis, then cable operators could not refuse carriage based on the argument that consumers are not willing to pay for minority cable networks. It alleges that cable operators' state that they cannot provide carriage because "there is already enough programming that targets people of color...[and] too many consumers are not willing to pay for minority cable networks to be added to their...cable television packages."[275] UBC believes that "a la carte could open up the cable industry to minority cable television networks."

d. Choice

A la carte would likely have a significant negative impact on consumer choice. Cable and satellite subscribers would lose the ability to pick and choose program networks by randomly scrolling through channel options now available on a tier. On this point, Comcast states that services offered a la carte would make channel surfing nearly impossible.[276] Themed tiers would also make it equally difficult to channel surf for desired programming. Moreover, a themed tier requirement would result in the arbitrary assignment of program networks and would frustrate subscribers' ability to easily select certain programming. Disney asserts that the practical difficulty of the government sorting through program networks to determine which "tier" on which they should be placed would be "imprudent and impossible."[277] Viacom states that while some individuals may have relatively narrow programming tastes, most watch a broad range of program genres and, thus, likely would need to purchase multiple themed tiers in order to satisfy their interests. According to Viacom, this problem would become magnified in multi-resident households.[278]

4. Experiences With A La Carte

a. International

A la carte sales of programming to consumers have been introduced by MVPDs in several other countries. The system used in Canada has drawn the most interest from commenters both as a model of how a la carte could be successfully implemented in the U.S., as well as an example of the difficulties associated with a la carte. A la carte has also been implemented or tested in Japan, Hong Kong, and France. Commenters argue that the experiences in these countries illustrate the illusory nature of the benefits of a la carte. For example, Disney posits that international a la carte offerings provide no basis to support imposition of a la carte requirements in the U.S. and it would be misguided for the Commission to consider potential a la carte regulations in the United States based on any international experiences.[279]

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[274] Pioneer Comments at 7-8; RTC Comments at 16 (asserting that although some program networks may not survive, this is not necessarily a negative result).

[275] UBC Comments at 2.

[276] Comcast Comments at 19-20.

[277] Disney Comments at 25.

[278] Viacom Comments at 28-29.

[279] Disney Comments at 33-34.

Canada. CU states that nearly all the major Canadian cable operators are offering programming on an a la carte basis, as well as in tiers. It argues that this demonstrates the feasibility of offering a la carte selection to consumers.[280] Opponents of a la carte counter that the cultural and regulatory institutions of Canada are significantly different from those in the U.S. and the Canadian system is unlikely to be successful if imported to the U.S. Furthermore, they argue that few Canadians take advantage of the choice offered by a la carte sales. Since Canada has been discussed as a potential model of the benefits and pitfalls of a la carte sales, the Canadian system is examined in detail in Appendix E of this Report. This examination leads to the conclusion that the Canadian model is not particularly successful and is unlikely to transfer successfully to the United States.

Japan. SkyPerfect, a direct to home ("DTH") satellite provider in Japan, was launched in 1996; the same year as EchoStar was launched in the United States. SkyPerfect offers a la carte channels in addition to channel packages. Disney asserts that SkyPerfect uses this model because the Japanese government requires it. Seven years after launch, at the end of 2003, six percent of television households in Japan subscribed to SkyPerfect. By comparison, at the end of 2003, nearly nine percent of U.S. television households subscribed to Echostar, and even greater number were subscribers to DirecTV. Accordingly, DTH penetration in Japan appears to have grown at a significantly slower rate than in the U.S. Disney argues that this is due in part to the mandatory a la carte requirement. Furthermore, as a result of the mandatory a la carte offering and lack of a consistent "basic" package, most individual channels continue to achieve less than 35 percent penetration of SkyPerfect's total subscriber base. Disney asserts that Japanese consumers do not appear to be embracing the a la carte option as is evidenced by the fact that a la carte subscriptions comprise, on average, less than 10 percent of a channel's total DTH subscriber base.[281]

Other Countries. PCCW, Hong Kong's largest utility, launched a digital subscriber line ("DSL") programming service in 2003, through which it offers approximately twenty-five channels on an a la carte basis. Disney reports that PCCW's choice to offer channels a la carte was based on PCCW's initial research, which indicated that the a la carte model was preferred over a basic bundling model. Although in business only a short time, PCCW already is exploring potential packaging strategies.[282] According to Disney, the distribution business models in France are similar to those in the United States. However, several years ago, French cable operator Noos experimented briefly and unsuccessfully with offering consumers a pure a la carte service.

b. Domestic

Premium networks have been available on an a la carte basis for many years. Despite this fact, several program networks commented that past efforts to launch program newtorks on an a la carte basis in the United States were fraught with difficulties and were generally unsuccessful. Satellite carriers, such as DirecTV, also have attempted to offer program services on an a la carte basis with little success. However, C-Band satellite carriers continue to offer many services on an a la carte basis.

Comcast explains that Home Team Sports, now SportsNet, was originally offered only as an a la carte service. Accordingly, it was unable to generate revenues consistent with management expectations or sufficient to justify the quality improvements management envisioned for the service. In the late 1980s,

[280] CU Comments at 7-8.

[281] Disney Comments at 33-34.

[282] *Id.* at 34.

it began migrating from a la carte to the expanded basic tier. According to Comcast, the move had a dramatic impact. For example, when the Baltimore County cable system moved it to the tier in 1995, there was a significant price reduction for subscribers. When offered a la carte, Baltimore County subscribers paid $15.99, but when the channel was moved to a tier, the effective price dropped to about $1. Comcast also states that subscribers had greater access to the service. As an a la carte service, Sportsnet had approximately 10,000 subscribers in Baltimore County, but when it was moved to the tier, the subscribership jumped to over 170,000. One additional result of the move to the tier is that Sportsnet has been able to substantially increase the quality of its service. Comcast states that the quality increases came in many forms: (1) acquisition of additional sports rights (*e.g.*, more professional and collegiate games), (2) more original programming (*e.g.*, pre- and post-game live programming, sports news programming), (3) more experienced on-air talent (*e.g.*, nationally-recognized game announcers), and (4) equipment and service upgrades (*e.g.*, introduction of HDTV).[283]

The Golf Channel launched as an a la carte service in 1995. According to Scripps, by 1996, it was teetering on the edge of bankruptcy because its subscription revenues at low take-rates could not cover its costs. The network then abandoned its a la carte model, migrated to expanded basic tiers, obtained wider distribution, and ultimately has become a successful tiered programming service with about 60 million subscribers.[284]

Disney Channel originally launched in 1983 as a premium a la carte service. Disney states that, as such, it was necessary for Disney Channel to constantly attract and retain new subscribers, requiring it to allocate a significant portion of its sales revenues toward marketing and promotion. In the mid to late 1990s, Disney Channel transitioned from a pay a la carte channel to a service that was offered as part of a widely-distributed Basic or Expanded Basic package. According to Disney, this enabled Disney Channel to expand rapidly and to reach a significantly larger and more diverse audience that was not required to pay a premium fee. With this greater subscriber penetration, Disney Channel was able to redirect funds previously committed to marketing and subscriber retention and spend them instead on high quality family programming. Disney posits that had Disney Channel remained a premium a la carte service, it is unlikely that it would contain as much original "family-friendly" programming that it does today.[285]

When it first launched service in 1994, DirecTV explored the possibility of offering an a la carte-like service called "Personal Choice." DirecTV states that it discovered, however, that subscribers found the process of choosing a la carte offerings too complex. According to the satellite carrier, one DirecTV executive involved in the research on Personal Choice observed that, while viewers supported a la carte in the abstract, they found choosing programming on an a la carte basis to be "paralyz[ing]." DirecTV states that its research regarding Personal Choice showed that customers overwhelmingly would limit their choices to the most well known channels (ESPN and the like), giving credence to program networks' claims that newer networks would struggle or fail in an a la carte environment.[286]

Commenters assert that there is evidence of actual harm to program networks resulting from themed tiers. Commenters note that DirecTV once offered a "family pack" option to its subscribers.

[283] Comcast Comments at 26-27. *See also* Tennis Reply at 4 (asserting that efforts to offer niche sports networks on an a la carte basis have failed in the past and that relegating niche sports networks to themed tiers is unworkable).

[284] Scripps Comments at 20.

[285] Disney Comments at 18-19.

[286] DirecTV Comments at 7-8.

Hallmark states that its service was offered on this themed tier, but negotiated with DirecTV to be moved to a more popular tier of service because viewership was low and distribution of the "Family" package remained limited.[287] A&E surmises that DirecTV discontinued this tier of service because there was insufficient interest to sustain it.[288]

Home satellite dishes ("C-Band" or "HSD") provide television signals to subscribers via satellites operating generally in the C-Band frequency.[289] Unlike DBS, which uses small dishes, HSD antennas are between four and eight feet in diameter and can receive a wide range of unscrambled (free) programming and scrambled programming purchased from program packagers that are licensed to facilitate subscribers' receipt of video programming.[290] There are approximately 30 satellites operating in the C-band, which carry over 500 channels of programming combined; approximately 350 channels are available free of charge and 150 are scrambled and require a subscription.[291] A number of these program services are offered on an a la carte basis, including most of the program networks that oppose the imposition of a mandatory a la carte requirement.[292]

The record was largely silent on the issue of C-Band's successful provision of a la carte programming. Turner, however, argues that C-Band provides empirical data that belies the expectation that a la carte reduces prices or is valued by consumers. The Superstar/Netlink Group (Superstar), the most popular provider of C-Band programming, offers channel-by-channel sales. However, Turner states, a la carte prices are substantially higher than the average channel prices when networks are purchased in bundles through this service. Subscribing to just four leading cable networks ESPN, CNN, TNT, and Lifetime costs $17.46 per month – an average of $4.37 per channel per month and adding Discovery qualifies a subscriber for the five channel discount and drops the monthly fee to $14.95, an average of $2.99 per channel per month. According to Turner, by subscribing to the SuperPak Basic package a subscriber could add another 29 popular channels for $25.99 per month– an average of 76¢ per channel per month.[293]

G. New Models

As reflected above, the harms of mandatory a la carte and themed tiers were the significant focus of attention by the majority of commenters. The Report now examines a different type of a la carte

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[287] Hallmark Comments at 4.

[288] A&E Comments at 34-35.

[289] To receive one or more scrambled channels, an HSD owner must purchase an integrated receiver-decoder from an equipment dealer and then pay a monthly or annual subscription fee to a program packager. HSD systems are typically designed to receive programming from several different satellites at several different orbital locations.

[290] Subscribership is measured by the number of authorized VideoCipher modules, which provide subscribers with access to scrambled programming.

[291] Over the past eight years, HSD has experienced a continued decline, with 502,191 households receiving C-band service as of June 30, 2003.

[292] *See* http://www.amersatt.com/Pick-a-Pak.htm (American Satellite Technology); http://skyvision.com/programming/alacarte.html (Skyvision); http://www.satelliteprogramming.com/new/cgi-bin/sps_home.asp (Satellite Programming Services, Inc.)

[293] Turner Reply Comments at 12.

regulation, one where program networks may remain bundled, but also are offered on an a la carte basis. Certain parties propose that the government act to mandate more channel selection alternatives. Consumers Union ("CU"), for example, envisions a quasi-Canadian paradigm, it calls "mixed bundling," where cable operators and satellite carriers offer programming on tiers and individual channels on an a la carte basis. CU states that consumers should have the option of picking and choosing programming, grouping together those they want, instead of paying for programming they do not watch or find offensive. In effect, CU believes that all programming beyond the basic tier should be unbundled, but cable operators should be able to retain the option of tiering, in addition to offering programming on an a la carte basis.[294] CU states that, under its proposal, independently-owned and public interest channels would be promoted alongside those owned by large media companies and new and diverse content providers would find it easier to obtain carriage.[295]

The Broadband Service Providers Association ("BSPA") supports a paradigm similar to CU's proposal, but calls its suggestion, "voluntary a la carte." According to BSPA, this approach is created when MVPDs are given the option of offering programming in a variety of packages or tiers that are different than the content bundles driven by the constraints of "most widely distributed tier" requirements found in current affiliation contracts. Like CU's suggestion, tiering would not be prohibited, but MVPDs could offer content in additional alternative packages that can address expressed consumer desire for more choice, control and flexibility. These new offerings could include new mini-tiers of content or individual channels. According to BSPA, this structure would enhance competition among MVPDs by allowing competing distributors the opportunity to define and offer their own solutions to consumer requests for either choice or diversity. It would also provide greater opportunities for consumers to validate the content they want and pay for with a better understanding of the relative costs of different content.[296] RCN, a member of BSPA, states that voluntary a la carte would allow cable operators to offer consumers smaller programming tiers, limited to the kind or categories of programming consumers most value, while still supporting programming diversity, because less-widely viewed niche programming could continue to be bundled with similar, but more widely-viewed channels.[297]

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[294] CU Comments at 10.

[295] *Id.* at 6-7.

[296] BSPA Comments at 11. BSPA asserts that voluntary a la carte is a solution that should receive further evaluation. It states that such an approach has significant potential that could be fully realized as the industry continues to deploy digital systems that do not have the technical limitations of current analog networks. BSPA states that this option cannot be fully understood, evaluated, or appreciated unless it is subjected to a multi-year market test. Several BSPA members are willing to bear the cost of implementing a multi-year test of voluntary a la carte to more fully determine its benefits and potential issues. *Id.* at 3-4. In order to conduct such test, BSPA suggests that the government remove certain contractual and regulatory barriers. These include, but are not limited to: (1) must carry; (2) retransmission consent; (3) tying arrangements; (4) "most widely distributed tier" requirements; (5) channel placement requirements; and (6) potential interim dual carriage requirements. *Id.* at 15-16. Contracts also would need to allow for the unbundling and repackaging of content at reasonable rates where the content producer and the distributor can share in margins produced by any higher prices for "a la carte" options. BSPA states that there are a number of pricing issues that may need to be re-evaluated or renegotiated to implement the test, such as: (1) channel placement discounts; (2) multi-service discounts or tying discounts; and (3) premiums charged for "a la carte" placement versus "most widely distributed tier" placement. *Id.* at 16.

[297] RCN Reply Comments at 5.

Several program networks oppose such proposals.[298] Turner asserts that "voluntary" a la carte would not be "voluntary" for program networks. Under such a regime, program networks would be legally prevented from following a business plan for a widely distributed channel and for negotiating in the marketplace for such distribution. Absent some clear market failure (which does not exist here), the government should not limit the contracting options of free market participants. Turner remarks that for the "government to deprive program networks of the ability to negotiate for such a term is not 'voluntary' – it is confiscatory."[299]

Joint Programmers state that even a relatively "modest" a la carte mandate, like those proposed, would drive capital away from niche networks because: (1) a la carte distribution would lack the "guarantee" of revenues provided by a network's current distribution contracts (with tier and penetration requirements and/or incentives); (2) without such a guarantee, investors could not be assured of any level of future performance of the network, or even whether an asset would continue to exist for the predictable future; (3) at the very least, the projected return on investment would be reduced; and (4) the investment would become significantly more unpredictable and risky, causing institutions to flee niche networks for safer havens.[300]

Disney illustrates the costs of having a program network offered on an a la carte basis as well as part of a tier. Through 1998, Disney Channel was offered in a hybrid fashion. Disney states that on some cable systems it was a premium service, on others it was part of a premium package or part of tiers, and on others it was on expanded basic. Disney comments that aggressive marketing of Disney Channel as part of a package of premium services with HBO and Showtime showed some gains; however, these proved to be short-lived. When Disney Channel was offered either as part of a new product tier or third tier with three to four newer cable networks (like Court TV and Sci-Fi) for between $3.95 and $5.95 per month, there was initial success. However, after the initial lift, penetration began to drop. Even at their peak, these tiers reached only 40 percent penetration and then only for a brief period. These strategies continued to require heavy investment in transactional costs associated with marketing and retention programs for the various methods of distribution, which, in turn, unavoidably diverted funds from programming. From 1990 through 1997, Disney Channel annually invested on average approximately 10 percent of its total revenue from a la carte sales on telemarketing, subscriber acquisition programs, and retention programs. In the late 1990s, it became clear that the hybrid approach was inefficient and too costly to sustain long-term. After Disney Channel's transition from a la carte to expanded basic, telemarketing, subscriber acquisition, and retention costs were *de minimis*, and Disney Channel could thus spend more of its total revenues on diverse, quality programming.[301]

Hallmark states that voluntary a la carte represents a "dangerous intrusion into the marketplace." Any regulatory program to promote "voluntary" a la carte service offerings to control cable rates would likely be accompanied by government involvement in pricing that adversely affected programmers and diversity in the past.[302] Cable operators agree that regulation of wholesale packaging and pricing arrangements could lead to regulation of a cable operator's retail operations and to a host of unintended

[298] *See* Disney Reply Comments at 8; Discovery Comments at 19; A&E Reply Comments at 3.

[299] Turner Reply Comments at 10.

[300] Joint Programmer Comments at 42-3.

[301] Disney Comments at 20-21.

[302] Hallmark Comments at 13.

consequences such as higher administrative costs, reduced investment, and diminished consumer choice.[303]

EchoStar agrees that the implementation of a voluntary a la carte system could be costly for both program networks and distributors, but such costs should not be an "insuperable obstacle." Echostar also suggests that such costs should not deter the Commission from encouraging voluntary a la carte offerings. It remarks that NCTA estimates that 30 percent of cable households subscribe to the digital tier and thus have the necessary hardware to make a la carte work. According to Echostar, coupling these digital cable households with the 20 percent of MVPD households that subscribe to DBS yields a sizeable portion of MVPD households that have the ability to receive programming on a per channel basis. As such, a voluntary approach will permit each entity to decide for itself what type of offerings best suits its business model.[304]

H. Recommendations for the Retail Market

The bundling of channels into tiers of service is, generally, an economically efficient way of providing MVPD subscribers with video programming. Although the current MVPD business model may result in some consumer dissatisfaction, government intervention through a la carte regulation likely will harm MVPDs, program networks, and especially MVPD subscribers. Further, although increases in MVPD rates continue to concern Congress, the Commission, and consumers, competition, as a remedy, is preferred to government intervention and all of its unintended negative consequences. A la carte, as a means to control rates, should be viewed through this same prism: competition, not regulation, is the answer.

The success of the marketplace is evident with DBS, which offers many tiers of service often at prices lower than those offered by cable operators. Dish Network offers the "America's Top 60" package for only $25 per month, other packages at incrementally higher prices, as well as several separate tiers devoted to foreign language programming. At $39 per month, DirecTV provides its "Total Choice" package of 90 video channels, which also includes local television stations. In addition, new satellite entrant VOOM has a package of 120 channels (35 in high definition) for $39.90.[305]

Indeed, there is a growing consensus that more choices in program selection will appear through marketplace forces and technological advances, even absent a legal mandate. Smaller Operators assert that the development of a highly competitive video marketplace obviates the need for government intrusion into program packaging and pricing.[306] SBC Communications, one of the largest telecommunications companies in the world, recently announced its intention to provide video services

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[303] *See* Smaller Operators Comments at 12.

[304] Echostar Reply Comments at 19.

[305] It was recently reported that Dominion Video, which operates the Christian-oriented Sky Angel satellite television service, will soon provide a la carte channels to its customers. *See Dominion/Sky Angel Gives Support to A La Carte*, SkyREPORT, November 18, 2004, at 2 ("DBS company is working on a package of about 15 family-oriented channels that will be added to its core slate of programming if the subscriber wants to pick up the channels.")

[306] Smaller Operators Comments at 13.

with a fiber-based, IP-driven network that would allow for "customizable channel lineups."[307] Verizon is also planning a large scale entry into the residential video programming market.[308] Whether these entries succeed, and whether they drive the development of new packaging and pricing models, should be left to the marketplace without the needless cost and distorting impact of unnecessary or excessive government regulation.

Television broadcast stations have recently begun using their excess digital spectrum to provide subscribers a limited offering of the most popular cable programming services at a low price. For example, U.S. Digital Television, Inc. ("USDTV") is leasing spectrum from broadcast television stations to provide an over-the-air 20 to 30 channel package for a price of $19.95 a month, less expensive than most expanded basic service tiers offered by cable operators. USDTV provides 35 channels in Salt Lake City and 24 channels in Las Vegas and Albuquerque of non-broadcast and broadcast programming.[309] It is planning to expand to 30 markets by the end of this year, and aims to serve all major markets. USDTV competitor, Digital Antenna Systems (DAS), an entity controlled by Emmis Broadcasting, is planning to distribute a similar package of local broadcast stations plus 20-30 cable networks to special receivers for $25 per month. Reportedly, it has 35 broadcast companies, representing 370 broadcast stations, signed on to date.[310]

Program choice, through marketplace forces, is growing. Many cable operators see a bright future for video-on-demand programming. In fact, Cox Communications CEO, Jim Robbins, has stated that the cable industry will eventually adopt video-on-demand as its business model.[311] Cable operators have offered VOD carriage to new program networks as an alternative to carriage on linear 24/7 channels.[312] As such, video-on-demand has increased program diversity on cable and has been the proving ground for

[307] *See* Press Release, *SBC Communications Announces Advances in Initiative to Develop IP-Based Residential Network for Integrated Video, Internet VoIP Services* (June 22, 2004). *See also*, Jen Belson and Matt Richtel, *SBC to Start Project to Send TV Over Lines*, New York Times, November 17, 2004, at C1. ("SBC Communications, as part of its effort to compete head-on with the cable industry for television subscribers, plans to announce today that it will pay $400 million to Microsoft for software used to deliver TV programming over high-speed data lines.")

[308] *See* Almar Latour, *Verizon, SBC Saddle Up to Compete Head to Head With Cable in TV Service*, Wall Street Journal, November 8, 2004, at B1.

[309] *See* U.S. Digital Television, Inc., *About USDTV!*, at http://www.usdtv.com/why_usdtv.php; *see also*, USDTV Press Release, *USDTV Surpasses 10,000 Subscriber Milestone*, September 22, 2004.

[310] Emmis Press Release, *Television Broadcasters Initiative Unveiled: Strategy Would Re-establish Relationship With Audience and Monetize the Digital Spectrum for Broadcasters*, April 20, 2004; Amy Maclean, *Eye Spy: Spotlight on Competition—Not Hot Air*, CableFAX Daily, October 6, 2004, at 5.

[311] *See* Frank Ahrens, *Sorry-No A la Carte Cable*, Washington Post, March 26, 2004, at E1. VOD also has the potential to change the current program network advertising model. *See* Kevin Corcoran, *Building VOD's New Ad Model*, Multichannel News, September 27, 2004, at 63 (unlike traditional linear program networks, VOD offers advertisers direct access to highly targeted demographic groups and the cost of reaching a specific audience segment through VOD can be "extremely" cost-effective).

[312] Shirley Brady, *Here's How to Get Comcast Carriage*, CableWORLD, June 21-July 4, 2004, at 21-26.

new networks.[313] VOD is also spurring the development of new applications that provide consumers more control over programming.[314]

Other products, such as digital video recorders ("DVRs"), are now available. A DVR is a device connected to a television set, either embedded in a set-top box or as a stand-alone device, which uses a hard disk drive, software, and other technology to digitally process and record programming. DVR technology allows a consumer to pause, replay, rewind, and fast-forward television programs as well as skip past commercials. DVRs do not play prerecorded videocassettes or DVDs, but can record pay-per-view signals, television series or any other content for playback at the subscriber's discretion. Enabled by this and other technologies, such as EPGs, it is anticipated that programming services will increasingly be offered in small tiers or on a pure a la carte on-demand basis, giving subscribers significant control over what they watch and pay for.[315]

Broadband, and video over internet protocol in particular, will eventually bring consumers more programming on an a la carte basis. Video streaming over the Internet, with its lower distribution costs, is becoming commonplace and may ultimately supplant existing non-Internet based platforms for the distribution of certain types of video content.[316] Bandwidth intensive video product will help spur broadband penetration. Increased broadband penetration would likely serve to initiate the creation of still more video streaming product.[317] As digital technology advances, video streaming over the Internet and

[313] *See* Ken Belson, *To Watch These Programs on Cable, You Have to Find Them First*, New York Times, June 7, 2004, at C1. (Matt Bond, Executive Vice President for Programming at Comcast states: "With video on demand, you can put niche programming on air that might not otherwise be available." Comcast has three exclusive on-demand channels: (1) Wisdom TV; (2) Anime Network; and (3) Atom TV.). Matt Stump, *Anime Finds VOD Success*, Multichannel News, September 6, 2004, at 31 (Anime Network has become so successful under the VOD model that it has been able to launch as a linear network). *See also*, Linda Moss, *Comcast Readies Hispanic VOD*, Multichannel News, September 27, 2004, at 24 (Comcast is assembling up to 200 hours of Spanish language on-demand programming for the end of 2004); R. Thomas Umstead, *Banse: New Nets Could be VOD-Based*, Multichannel News, September 27, 2004, at 22 (Comcast is hoping to cultivate three on-demand channels as part of its new joint venture with Sony Pictures Entertainment, as part of the MGM purchase).

[314] For example, new forms of EPGs are now being introduced by cable operators to work in conjunction with VOD. *See* Steve Donohue, *"I-Guide" Starts to Roll Out*, Multichannel News, September 20, 2004, at 6. (Gemstar and Comcast's new high resolution "I-Guide" permits subscribers to easily navigate on-demand programming, among other features.). *See also*, Mavis Scanlon, *Coming Soon to Programming Guides: Can't Miss VOD*, CableWorld, July 5-18, 2004 at 18.

[315] *See* Cablevision Reply Comments at 3.

[316] *See* Matt Stump, *Dutch Treat for IPTV* Multichannel News, September 20, 2004, at 54. (Pace Micro Technology recently debuted a new, below-$100 IPTV set top box, permitting video-on-demand over the Internet, at the same time Microsoft announced a major IPTV trial with Telecom Italia); Mike Langberg, *Forget A La Carte Cable Idea;The Future is in Internet TV*, The Mercury News, July 23, 2004; *Phone Lines Delivers Next-Gen TV*, Wired News, September 27, 2004, available at http://www.wired.com/news/print/0,1294,65105,00.html. (television delivered over Internet protocol is poised for a breakthrough in Europe and the United States.).

[317] *See, e.g.*, Paul Bond, *VOD Service Boxes Up VC Money*, Hollywood Reporter East, July, 12, 2004, at 5. (Akimbo plans to sell a set top box that downloads on-demand content from the Internet over a broadband connection); Mark Seavy, *Akimbo Working With CE Makers on Internet-Based TV Service*, Communications Daily, October 25, 2004, at 2.

other distribution alternatives will become more competitive.[318] New products offered on an a la carte basis via broadband are now available. For example, Starz Encore recently launched "STARZ! Ticket on Real Movies," an Internet-based subscription movie service enabling consumers to select from among at least one hundred movies available for downloading over broadband connections. The service will allow subscribers to access and view premium movies without subscribing to either cable or direct broadcast satellite service.

In response to these competitive pressures and technological options, cable operators now offer a variety of channels and packages. Comcast, for example, offers over 1,000 program and price combinations and allows its subscribers to create a mix of services to meet varied program interests or financial constraints.[319] Comcast states that pay-per-view and VOD programming provide countless additional programming options for its subscribers.[320] Charter offers a limited "basic" tier, an expanded basic tier, and many additional channels on four separate digital tiers (the "Family and Information Tier," the "Movie Tier," the "Sports Tier," and the "Latino Tier").[321] BHN has focused on growing its digital offerings, which include a digital tier, a wide array of on-demand programming, a new digital sports cluster, and a digital video recorder option.[322] Additionally, all MVPDs offer subscribers dozens of premium and pay-per-view channels.

There is agreement that more consumer choices will appear as technology progresses and video competition flourishes. Considering all trends, the government should implement policies that unleash competition and motivate MVPDs to innovate, rather than to force providers to offer programming on a per channel or themed-tier basis. The government should not displace the current economic model, which is working to the benefit of MVPDs and their customers, with regulations which will likely distort the marketplace and slow down advances in technology that will eventually be the answer to the questions posed in this proceeding.

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318 *See* Testimony of Thomas G. Baxter, President, Time Warner Cable, *On A La Carte and Theme Tier Regulation*, Before the House Committee on Energy and Commerce, Subcommittee on Telecommunications and the Internet, July 14, 2004 (the "Internet is poised to affect video distribution in unimaginable ways").

319 For example, in Arlington, Virginia, Comcast customers can choose from 11 different tiering options ranging from the basic service tier to a tier of high definition programming. Comcast does not charge separately for the latter programming, but only for the HD-capable set-top box needed to receive it.

320 Comcast Comments at 9-10.

321 Charter Comments at 3.

322 BHN Comments at 8-9.

III. THE WHOLESALE MARKET FOR VIDEO PROGRAMMING

The second issue addressed in the Report concerns the acquisition of programming by MVPDs at the wholesale level. In negotiations for programming, MVPDs seeking to acquire the rights to an individual program network are sometimes presented with the option or obligation to contract for one or more other networks which might not be desired individually. The process and economics of this contracting have raised questions as to whether it results in the carriage of less desired or less popular programming, raising the cost of service to the public or taking away channel capacity that MVPDs could devote to other better uses. Among the elements of the relationship examined here are the statutory provisions and regulatory requirements governing the parties, such as retransmission consent for broadcast stations. The Report also examines some of the rates, terms, and conditions governing the contractual relationship between the parties.

A. Industry Overview

The number of program networks has increased significantly over the last ten years. As of year-end 1994, there were approximately 106 non-broadcast program networks available for carriage by MVPDs. As of June 2003, there were more than 339 national non-broadcast program networks carrying a wide array of diverse news, sports, and entertainment programming.[323] Nine of the top 20 non-broadcast program networks (ranked by subscribership) are vertically integrated with a cable operator.[324] Sports programming warrants special attention because of its widespread appeal and strategic significance for MVPDs. There are at least 84 regional networks, 28 of which are sports channels, many owned at least in part by large cable companies. There are also 37 regional and local news networks that compete with local broadcast stations and national cable news networks. Program networks on digital tiers, especially sports, childrens, and female-oriented genres, have grown in popularity as digital penetration levels have increased.[325] In 2003, there were 61 programming services that were planned, but not yet operational.[326]

B. Requirements and Remedies

1. Broadcast Signal Carriage Requirements

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[323] *See 2003 Video Competition Report*, 19 FCC Rcd at 1617.

[324] *Id.*, 19 FCC Rcd at 1691.

[325] The Beta Research Group recently released results from its 2004 Beta Research Digital Cable Subscriber Study. Beta conducted a total of 801 telephone interviews in July and August with a national sample of digital cable subscribers from 32 cable systems. When digital cable subscribers were asked the perceived value (in dollar terms) of digital basic cable networks per month, the following digital networks were assigned the following values: (1) Soapnet--$2.18 per month; (2) Fox Sports Digital Nets--$2.16 per month; (3) MTV Jams--$1.97; (4) Nicktoons--$1.93; (5) Noggin--$1.91; (6) Nick Games and Sports--$1.90; (7) Toon Disney--$1.88; (8) Discovery Kids Channel--$1.85; (9) Lifetime Movie Network--$1.84; and (10) MTV Hits--$1.83. *See Beta releases Digital-Sub Study*, Multichannel News, October 20, 2004.

[326] *See 2003 Competition Report*, 19 FCC Rcd at 1693.

Under Section 614 of the Act, a commercial television broadcast station is entitled to request mandatory carriage on cable systems located within the station's market.[327] Commercial broadcast stations that do not request mandatory carriage may elect to negotiate for carriage with MVPDs. This retransmission consent negotiation process is discussed below. The Act and the Commission's rules state that systems with more than 12 usable activated channels must carry local commercial television stations, "up to one-third of the aggregate number of usable activated channels of such system[s]."[328] Beyond this requirement, the carriage of additional television stations is at the discretion of the cable operator. With regard to the placement of local commercial television stations, commercial broadcast stations may choose among several channel positions on which to be carried[329] and the signals must be made available to every subscriber of the cable system.[330] Under Section 615 of the Act, and in addition to commercial television stations, cable systems are obliged to carry local noncommercial educational television stations ("NCE stations") according to a different formula and based upon a cable system's number of usable activated channels.[331] NCE stations have channel positioning rights similar to their commercial counterparts.[332]

The terrestrial broadcast television industry is currently transitioning from an analog format of broadcasting to a digital form of broadcasting. Broadcast stations are required by statute to transition to digital by January 1, 2007, if certain conditions are met.[333] Digital television allows broadcasters to transmit a high definition signal, several standard definition television signals ("multicasting"), or ancillary services in addition to video programming. In 2001, the Commission adopted rules related to the cable carriage of digital broadcast television signals.[334] The Commission held that a digital-only television station can immediately assert its right to carriage on a local cable system.[335] The Commission also ruled that a television station that returns its analog spectrum and converts to digital operations must be carried by local cable systems.

Section 338 of the Act requires satellite carriers to carry upon request all local television broadcast stations' signals in local markets in which the satellite carrier carries at least one local television broadcast signal pursuant to the statutory copyright license (*i.e.* the "carry-one, carry-all" requirement).[336] Satellite carriers are not required to provide the signal of a local television broadcast station to subscribers

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[327] 47 U.S.C. § 534; 47 C.F.R. §76.56. *See Broadcast Signal Carriage Issues*, 8 FCC Rcd 2965 (1993) ("*Must Carry Order*"); *Broadcast Signal Carriage Issues*, 9 FCC Rcd 6723 (1994) ("*Must Carry Reconsideration*"). A station's market for carriage purposes is its "designated market area," or DMA, as defined by Nielsen Media Research.

[328] 47 U.S.C. § 534(b)(1)(B); 47 C.F.R. § 76.56(b)(2).

[329] 47 U.S.C. § 534(b)(6); 47 C.F.R. §76.57.

[330] 47 U.S.C. § 534(b)(7); 47 C.F.R. § 76.56(d).

[331] 47 U.S.C. § 535(a) and (b); 47 C.F.R. § 76.56(a).

[332] 47 U.S.C. § 535(g)(5); 47 C.F.R. § 76.57(b).

[333] 47 U.S.C. § 309(j)(14).

[334] *See generally*, *Carriage of Digital Television Broadcast Signals*, 16 FCC Rcd 2598 (2001).

[335] *Id*, 16 FCC Rcd at 2606.

[336] *See* 47 U.S.C. § 338. *See DBS Broadcast Carriage Report and Order*, 16 FCC Rcd at 1934, *clarified*, *Implementation of the Satellite Home Viewer Improvement Act of 1999; Broadcast Signal Carriage Issues*, 16 FCC Rcd 16544 (2001).

in that station's local market on any particular channel number or to provide the signals in any particular order, except that the satellite carrier must retransmit the signal of the local television broadcast stations to subscribers in the stations' local market on contiguous channels. Congress did not specifically enact DTV carriage requirements for satellite carriers. The Commission, however, is considering how the local-into-local SHVIA requirements apply to DBS in the digital carriage context.[337]

2. Retransmission Consent

Under Section 325 of the Act, cable operators, satellite carriers, and other MVPDs are prohibited from retransmitting the signal of a commercial television station, unless the station whose signal is being transmitted consents or chooses mandatory carriage.[338] Congress enacted the retransmission consent provisions to allow a broadcast station to negotiate carriage of its broadcast signal for the mutual benefit of the parties involved. Every three years, a commercial television station must elect to either grant retransmission consent or pursue its statutory carriage rights.[339] Under the Act and the Commission's rules, television stations are prohibited from entering into exclusive retransmission agreements.[340]

Section 325(b)(3)(A) expressly directs the Commission to consider the impact of its retransmission consent regulations on basic service tier rates.[341] Section 325 reflects Congress' concern over the interplay between retransmission consent and basic rates. In 1993, when the Commission first considered this question, it found little evidence of rate impact and declined to regulate retransmission consent rates at that time.[342]

The Commission has established certain retransmission consent policies for digital broadcast stations.[343] A commercial television station, broadcasting in both formats during the digital transition period, may choose must carry or retransmission consent for its analog signal and retransmission consent for its digital signal. A DTV-only commercial television station may elect either retransmission consent or must carry. A DTV-only noncommercial station is entitled to must carry. While a noncommercial television station does not have retransmission consent rights under Section 325 of the Act, it may enter into digital carriage agreements with MVPDs. A television station electing retransmission consent may negotiate with a cable operator for partial carriage of its digital television signal. The current prohibition

[337] *Carriage of Digital Television Broadcast Signals*, 16 FCC Rcd at 2658.

[338] *See* 47 U.S.C. § 325(b)(1)(A), (B); 47 C.F.R. § 76.64

[339] *See* 47 C.F.R. § 76.64(f). In the last retransmission consent election in October 2002, nearly all broadcast stations elected retransmission consent. *See, e.g.*, Brigitte Greenberg, *Most TV Stations Go For Retrans Consent Over Must Carry*, Communications Daily, October 3, 2004, at 4-5. (The majority of broadcast stations opted for retransmission consent with only stations in smaller markets choosing must carry). This report does not reflect the fact that noncommercial television stations cannot elect retransmission consent and have must carry as their only option.

[340] *See* 47 U.S.C. § 325(b)(3)(C); 47 C.F.R. § 76.65; *Implementation of Satellite Home Viewer Improvement Act of 1999, Retransmission Consent Issues: Good Faith Negotiation and Exclusivity* 15 FCC Rcd 5445, 5463 ("*Good Faith Order*"). Under the Act, the exclusivity requirements are effective "until January 1, 2006." *See* 47 U.S.C. § 325(b)(3)(C).

[341] 47 U.S.C. § 325(b)(3)(A).

[342] *Broadcast Signal Carriage Issues,* 8 FCC Rcd at 3005-06.

[343] *See generally*, *Carriage of Digital Television Broadcast Signals*, 16 FCC Rcd at 2609-2613.

on exclusive retransmission consent agreements encompasses a television station's analog and digital signals.[344]

Section 325(b)(3)(C) of the Act requires broadcasters to negotiate in good faith with cable operators and other MVPDs with respect to carriage of their signals.[345] In implementing this provision, the Commission determined that the statute did not intend to subject retransmission consent negotiations to detailed substantive oversight by the Commission.[346] In promulgating the good faith provision, Congress specified that negotiating different terms and conditions among different MVPDs, based on competitive marketplace considerations, is not a failure to negotiate in good faith.[347] The Commission found that, *inter alia*, proposals for carriage conditioned on carriage of any other programming, such as a broadcaster's digital signals, an affiliated cable programming service, or another broadcast station either in the same or a different market is presumptively consistent with competitive marketplace considerations and the good faith negotiation requirement.[348] Nevertheless, a MVPD may demonstrate, based on the totality of the circumstances of a particular retransmission consent negotiation, that a television broadcast station breached its duty to negotiate in good faith. The Commission entertains specific good faith disputes, and determines whether a particular party has provided evidence to overcome the stated presumptions, in an adjudicatory proceeding.[349] The good faith negotiation requirements are effective until January 1, 2006.[350]

In the *Digital Must Carry NPRM*, the Commission asked whether it should prohibit "tying" arrangements, in which the television station requires a cable operator to carry the station's digital signal as a precondition for permission to carry the analog signal.[351] ACA urged the Commission to prohibit broadcasters from tying analog carriage to digital carriage to prevent small cable operators from suffering financial distress.[352] While acknowledging the important concerns raised by ACA, the Commission did not adopt rules specifically prohibiting tying arrangements in the *Digital Must Carry First Report and Order*.[353] The Commission did, however, commit to monitor potential anti-competitive conduct by broadcasters. The Commission sought further comment on issues relevant to the carriage of digital signals by small operators in the *Digital Must Carry Further Notice* because the record did not contain

[344] *Id.*

[345] 47 U.S.C. § 325(b)(3)(C); 47 C.F.R. § 76.65.

[346] *See Good Faith Order*, 15 FCC Rcd 5445.

[347] 47 U.S.C. § 325(b)(3)(C)(ii).

[348] *Good Faith Order*, 15 FCC Rcd at 5469. In 2001, the Commission applied this principle in rejecting a complaint brought by EchoStar. The Commission stated that "offering retransmission consent in exchange for the carriage of other programming such as a cable channel" is "consistent with competitive marketplace considerations." *See EchoStar Satellite Corporation v. Young Broadcasting, Inc*, 16 FCC Rcd 15070, 15079 (CSB 2001) (stating that "[g]ood faith negotiation requires only that the broadcaster at least consider some other form of consideration if the MVPD cannot accommodate such carriage.")

[349] *See* 47 C.F.R. § 76.65(c).

[350] *See also,* 47 C.F.R. § 76.65(f) (good faith negotiation requirement sunsets at midnight on Dec. 31, 2005).

[351] *See* 13 FCC Rcd. at 15118.

[352] *See* Small Cable Business Association (now ACA) NPRM Comments at 24-27.

[353] *See Carriage of Digital Television Broadcast Signals*, 16 FCC Rcd at 2613.

adequate evidence on this issue. In response to the Commission's questions, small cable operators alleged, as they do in this proceeding, that television broadcast networks engage in unfair retransmission consent tying arrangements which harm independent cable operators and their customers.[354] The Commission will address these concerns again in the forthcoming *DTV Must Carry Second Report and Order*.

A controlling stake in DirecTV was recently purchased by News Corp., which owns the Fox Broadcasting Network, interests in several program networks, and several Fox television stations. In granting the license transfer from Hughes to News Corp., the Commission recognized the potential harms to non-affiliated MVPDs arising from the combination of a broadcaster and an MVPD.[355] The Commission attached conditions to the merger and extended the commitments News Corp. proposed regarding non-discriminatory access to program networks to encompass access to any broadcast station that News Corp. owns and operates, or on whose behalf it negotiates retransmission consent.

Certain parties have argued that the Commission's analysis of the transaction bears some relevance on the present discussion.[356] This represents a misunderstanding of the nature of the Commission's transaction review process as well as the specifics of the transaction between News Corp. and Hughes Electronics. The transaction review process at the Commission is directed at examining *changes* in the competitive landscape that are a direct result of the transaction at issue. To the extent the Commission discussed the "market power" that might reside in the combined entity, it was not passing upon the competitive balance of negotiating power that normally exists between broadcasters/programmers and MVPDs. All differentiated products, such as video programming, possess some degree of market power in the sense that there are no perfect substitutes. The critical question in any analysis involving differentiated products is whether the existing degree of market power is sufficient to allow the firm to profitably engage in the hypothesized anticompetitive activity. In the News Corp. transaction, the potential refusal to sell to competing MVPDs, or vertical foreclosure, was the activity of concern. Commission staff rigorously measured News Corporation's incentive and ability post-transaction to engage in the hypothesized activity and determined that, while permanent foreclosure was unlikely, temporary foreclosure was a real public interest concern.[357] Thus, nothing in the analysis of the News Corp./DirecTV transaction should be read to suggest that the Commission has concluded that the market power of broadcasters is sufficient to lead to competitive harms in the absence of vertical integration.

3. Network Nonduplication and Syndicated Exclusivity

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[354] The Commission has before it a Petition for Inquiry into Retransmission Consent Practices ("Petition"), filed by ACA on October 1, 2002. In its Petition, the ACA requested that the Commission initiate a formal inquiry, under Section 403 of the Act, to investigate the retransmission consent practices of certain television broadcast station groups. In its Petition, ACA asserts that broadcast networks and station groups engage in unfair retransmission consent tying arrangements that result in harm to small cable operators and their customers. This Petition has not been released for public comment and remains pending before the Commission.

[355] *See General Motors Corporation and Hughes Electronics Corporation—News Corporation Limited*, 19 FCC Rcd 473, 565-68, 572-75 (2004) ("*News-Hughes Merger Order*").

[356] *See, e.g.*, ACA Comments at 31; RTC Comments at 11.

[357] *See News-Hughes Merger Order* (Appendix D).

The network non-duplication[358] and syndicated exclusivity[359] rules entitle a broadcaster to prevent a cable operator from carrying a competing broadcast signal. Specifically, these rules permit a local television broadcast station to require a local cable operator to black-out programming, to which it owns the exclusive in-market broadcast rights, that is also broadcast by a distant television station carried on the cable system. Network non-duplication and syndicated exclusivity are aimed at protecting the economic interests of local television stations vis-à-vis distant market stations as well as protecting the copyright interests of the programming itself. The Commission first promulgated these regulations more than 20 years ago to protect the advertising revenue of local broadcasters. The legislative history of the 1992 Cable Act specifically addressed the interplay of network non-duplication with retransmission consent: "[T]he Committee has relied on the protections which are afforded local stations by the FCC's network non-duplication and syndicated exclusivity rules. Amendments or deletions of those rules in a manner which would allow distant stations to be substituted on cable systems for carriage [f]or local stations carrying the same programming would, in the Committee's view, be inconsistent with the regulatory structure created in [the Act]."[360]

4. Antitrust

The Clayton Act and the Robinson-Patman Act are designed to restrict a range of anticompetitive conduct.[361] The Supreme Court's decision in *Jefferson Parish Hospital District. No. 2 v. Hyde* ("*Jefferson Parish*") is the seminal case for analyzing tying and bundling arrangements under these antitrust laws.[362] In *Jefferson Parish,* the Court stated that "a tie has been illegal only if the seller is shown to have sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product…."[363] The Court found that there is nothing inherently anticompetitive about tying or bundling. On this point, the Court stated that, "[b]uyers often find package sales attractive; a seller's decision to offer such packages can merely be an attempt to compete effectively—conduct that is entirely consistent with the Sherman Act."[364] Just this term, the Court warned the lower courts to be mindful of "false positives" (*i.e.*, mistaken condemnation of pro-competitive conduct) in applying the antitrust laws.[365] Specifically, the Court admonished that "[m]istaken inferences and the resulting false condemnations are especially costly, because they chill the very [types of competitive] conduct the antitrust laws are designed to protect."[366]

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[358] 47 C.F.R. §§ 76.92-76.95.

[359] 47 C.F.R. §§ 76.101-76.110.

[360] S. Rep. No. 102-92, at 38.

[361] 15 U.S.C. § 13; 15 U.S.C. § 14. The Clayton Act provides civil penalties for specific types of restraints on trade, such as exclusive dealing arrangements and tying. The Robinson-Patman Act governs price discrimination in interstate commerce between buyers of commodities of similar grade and quality.

[362] 466 U.S. 2 (1984) (Justice O'Connor's Concurring Opinion is important in the analysis)

[363] *Id.* at 34 (internal citation omitted).

[364] *Id.* at 12.

[365] *Verizon Comm. Inc. v. Law Offices of Curtis V. Trinko,* 124 S. Ct. 872, 882 (2004).

[366] *Id., citing Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)) (internal quotations omitted).

Commenters claim that large media companies have power in the programming market and have used such power to the detriment of competition and consumer welfare by conditioning carriage of "must-have programming" with the carriage of non-essential programming.[367] To the extent that any network could achieve "market power" and engage in anticompetitive conduct, Joint Programmers suggest that cable operators have ample remedies under existing antitrust laws.[368] Viacom agrees and argues that in the absence of MVPD/programmer vertical integration, an individual broadcast network does not have "sufficient economic power in the tying market to coerce purchaser acceptance of the tied product."[369] It states that it is not sufficient for a complainant to demonstrate that a network owned station merely possesses some degree of market power; it must show that such power is sufficient to coerce acceptance of the tied product. Viacom believes that a reviewing court almost certainly would reject any claim that a single network station has coercive market power.[370]

C. Historical Practices and Outcomes

While most MVPDs believe that bundling at the retail level conveys benefits, some operators believe that they are harmed when program networks are able to dictate the composition of the retail bundle. The RTCs offer a historical timeline of programmers' bundling practices over the last 30 years to demonstrate the increasing negative effects the practices has had on small operators. They state that contractual provisions mandating carriage on the basic tier were not historically ubiquitous. In the early 1980s, it was not uncommon for contracts for even the most popular program networks to allow cable operators to decide tier placement and packaging of such services. Rather than a requirement that a service be made available on a specific tier these contracts would contain sliding scale rates, measured on a per subscriber basis, which were inversely proportional to subscriber penetration for the service on that operator's system. In other words, the operator's per subscriber cost for the service increased as the penetration for the tier on which the service was offered decreased.[371]

RTCs state that in the mid-1980s, a series of judicial decisions that eliminated the Commission's first two sets of must carry rules, as well as enactment of the 1984 Cable Act that eliminated local rate regulation, created incentives for cable operators to begin experimenting with reducing or eliminating multiple service tiers and replacing "skinny basic" tiers with "fat basic" tiers. As space on the basic tier became available for cable programming services, the stronger, more popular programming services

[367] ACA Comments at 3. Commenters, such as ACA, also recommend that the antitrust laws, and the Commission's application of similar regulatory requirements, be updated to reflect the current media marketplace. ACA suggests that Congress should amend the Clayton Act and the Robinson-Patman Act to bring "satellite and broadcast programming" expressly within the scope of those statutes. This, it argues, will provide private parties and the federal government with clear antitrust authority to challenge current programming practices. *Id.* at 19.

[368] Joint Programmers Comments at 69.

[369] Viacom Reply Comments at 13, *citing Hack v. President and Fellows of Yale College,* 237 F.3d 81, 86 (2d Cir. 2000).

[370] *Id.* Television networks, such as Fox, and television group owners, such as Hearst-Argyle, want an antitrust exemption from the Justice Department to permit all television stations in one market to negotiate jointly with cable systems on retransmission consent rights. They argue that relief is needed because of cable's "monopoly" status is many markets. *See* Tack Nail, *Fox Wants Antitrust Waiver for Stations to Negotiate With Cable*, Communications Daily, January 25, 2002, at 4; Doug Halonen, *Broadcast Factions Banding Together*, Electronic Media, January 14, 2002.

[371] RTC Comments at 4-5.

began to replace their sliding scale rate structures with so-called "neighborhood" provisions that would require the MVPD to carry the service on a tier that contained, for example, at least 10 of the top 14 most widely-viewed cable programming services. According to RTCs, such provisions were common in the contracts tendered by the larger, well-established program networks or their affiliated services.[372]

RTCs note that in 1992, Congress re-imposed both rate regulation and broadcast signal carriage requirements on the cable industry. The result was that, in many cases, program networks were forced off the basic tier as cable operators sought to limit the effects of local rate regulation by creating skinny basic tiers meeting the statutory basic service tier requirements. In response, popular program networks modified their contracts to allow cable operators to offer broadcast basic tiers as long as their programming services remained available to virtually all (typically at least 95 percent) of the cable operator's customers.[373]

When amending Section 325 in the 1992 Cable Act, Congress stated that: "[c]able operators pay for the cable programming services they offer to their customers; the Committee believes that programming services which originate on a broadcast channel should not be treated differently."[374] Congress concluded that "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals" and public policy should not support a system "under which broadcasters in effect subsidize the establishment of their chief competitors."[375]

Congress specifically recognized that, in the exercise of their retransmission consent rights, broadcasters may seek alternative forms of compensation.[376] It stated that "[Some] broadcasters may not seek monetary compensation, but instead negotiate other issues with cable systems, such as joint marketing efforts, the opportunity to provide news inserts on cable channels, or the right to program an additional channel on a cable system."[377]

In 1993, retransmission consent disputes between cable operators and television stations threatened the continued cable carriage of many local broadcast stations in Connecticut and elsewhere.[378] This and other disputes were resolved when three of the then four major broadcast networks agreed to proposals to grant retransmission consent for network-owned stations in return for cable carriage of, and payment for, new network-owned cable channels. In the years to follow, in return for granting retransmission consent, many networks were able to successfully launch new cable networks through retransmission consent negotiations.

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[372] *Id.* at 5.

[373] *Id.* at 6.

[374] S. Rep. 102-92, at 35.

[375] *Id.*

[376] *Id.*

[377] *Id.*

[378] *See, e.g.*, Jeannine Aversa, Rachel W. Thompson & Rod Granger, *Storm Still Brews in Conn. as FCC Readies Final Must-Carry Rules*, Multichannel News, Mar. 8, 1993 (noting Cablevision's threat to drop several broadcast stations, including those in Boston and Hartford/ New Haven "if they don't forgo payment for carriage.").

Currently, owners of local television broadcast stations that elect retransmission consent are generally compensated by one or more of the following: (1) retransmission consent fees; (2) cable advertising availabilities; and/or (3) where the station owner also owns non-broadcast program networks, it may grant retransmission consent rights in exchange for carriage of its program networks by the MVPD. At least one study finds that historically, most broadcasters have opted for (or settled for) in-kind compensation from cable operators in exchange for retransmission consent.[379]

During the initial retransmission consent negotiations eleven years ago, the cable industry made clear that it would not pay cash for the carriage of broadcast signals.[380] Disney states that, as a consequence of the cable industry's position, many broadcasters negotiated instead for cable operators to carry the broadcasters' affiliated programming channels.[381] Disney states that it offers compensation alternatives for operators when negotiating retransmission consent agreements. It remarks that some small cable operators wish to retransmit an ABC owned station, but do not want to pay cash for the carriage, and yet they lack sufficient capacity on the same cable system to carry commonly-owned cable channels. In these instances, it states that ABC has agreed to allow carriage of its station in market A in return for cable carriage of an affiliated channel in market B where the cable operator does have sufficient channel capacity. Disney states that ABC will continue to work in good faith to accommodate the needs of smaller cable system operators. It asserts that these practices are accommodations, not abuses, and in no way argue in favor of changes in retransmission consent.[382]

Fox Cable comments that current retransmission consent arrangements are consistent with the Commission's good faith policy and rules. It asserts that the Commission expressly permits offering retransmission consent on a barter basis.[383] Viacom adds that, to the extent an MVPD believes that an individual broadcaster has acted in bad faith in the context of retransmission consent negotiations, the aggrieved party may file a good faith complaint with the Commission. Viacom asserts that no commenter in this proceeding has suggested that this complaint process is in any way insufficient to deal with specific instances of bad faith negotiation.[384]

D. Current Broadcast Signal Carriage Arrangements

1. Benefits of Retransmission Consent

Fox Cable argues that retransmission consent arrangements have led to tangible public interest benefits by contributing additional content to the "marketplace of ideas."[385] It states that when a

[379] *See* Federal Communications Commission, OPP Working Paper #37, *Broadcast Television: Survivor in a Sea of Competition*, at 29.

[380] *See, e.g.*, Rachel W. Thompson, *TCI Cuts 14 'Zero Pay' Carriage Agreements*, Multichannel News, June 21, 1993.

[381] Disney Comments at 42-43.

[382] *Id.* at 45.

[383] Fox Cable Comments at 22-23.

[384] Viacom Reply Comments at 18.

[385] *See* Linda Moss, *The Upside of Retrans*, Multichannel News, January 27, 1997, at 34A ("Many local channels born out of contentious retransmission consent negotiations have proved a plus for cable operators.").

broadcaster negotiates for carriage, it is essentially asking the cable system to purchase a bundle of services together – the broadcast channel for which retransmission consent is required and the affiliated cable channel. According to Fox Cable, by refraining from interfering in this negotiation, the government has chosen to permit the retransmission consent process to benefit from the economic efficiencies generated by bundling. Fox Cable states that this approach has fostered an environment in which new channels and new content can emerge and thrive.[386]

Disney argues that broadcasters, like any business, should be compensated for their product if distributed and sold by another entity. Disney asserts that broadcasters invest billions of dollars annually to create the "most valuable and most desired television channels in the industry" and should have the right to be compensated for that product.[387] Disney negotiates retransmission consent only for the ten ABC owned television stations. Disney states that it offers cable and satellite operators a stand-alone cash retransmission consent deal, in addition to an offer to secure retransmission consent for one or more of the ABC owned television stations in return for carriage of Disney-ABC cable program services. Disney states that its cash retransmission offer is "completely reasonable" and economically supportable. It states that the average value for the ABC Owned Television stations falls within the range of $2.00 to $2.09 per subscriber, well in excess of the cash price of .70-.80 cents currently offered by ABC to MVPDs.[388]

2. Harms of Retransmission Consent and Other Requirements

Large and small cable operators, programming networks and satellite carriers have uniformly disparaged retransmission consent. According to Cablevision, broadcasters have withheld retransmission consent even though they are supposed to be the trustee of the public airwaves on behalf of consumers, unless cable operators agree to carry one or more of the broadcast network's affiliated program networks, often at above-market prices. Cablevision asserts that broadcasters further require that their affiliated programming be placed on the most popular programming tiers, regardless of whether cable subscribers want to watch it, and sometimes before the affiliated network has even been launched.[389]

Turner states that if the Commission (or Congress) is concerned about the size and cost of the expanded basic tier, it cannot ignore the question of whether the retransmission consent regime remains in the public interest.[390] Cablevision agrees. It notes that in 2004, 56 national cable networks are held by a broadcast affiliate, an increase from eight in 1993, just after retransmission consent was enacted, and an increase from 19 in 1996.[391] The forced carriage of many of these networks may even displace services more desired by subscribers.[392] Time Warner states that almost all stations affiliated with the top six

[386] Fox Cable Comments at 23.

[387] Disney Comments at 38-39.

[388] *Id.* at 43.

[389] Cablevision Reply Comments at 7-8. Several other commenters have similarly argued that retransmission consent is harmful. *See, e.g.*, ACA Comments at 30-38; Echostar Comments at 2-7; and BHN Comments at 7.

[390] Turner Reply Comments at 17.

[391] Cablevision Reply Comments at 8.

[392] *See* Discovery Networks *Ex Parte*, October 18, 2004 (The expanded basic tiers of New York DMA cable operators are taken up by broadcast-affiliated program networks to the detriment of unaffiliated networks).

networks choose retransmission consent (rather than must carry) and that to remain competitive with DBS, it has no choice but to carry local broadcast signals.[393]

ACA and similar groups[394] state that retransmission consent and other signal carriage requirements enable network owners and major affiliate groups to restrict how smaller cable operators package programming and how consumers can choose programming in local markets.[395] Under current law, ACA asserts that broadcasters, *inter alia*: (1) have the ability to withdraw a broadcast signal during retransmission consent negotiations thus giving broadcasters powerful leverage over local cable systems; (2) have the ability to condition retransmission consent on carriage of affiliated programming resulting in carriage of, and payment for, unwanted programming; and (3) use affiliate contracts to restrict consumer access to broadcast signals.[396] ACA also asserts that retransmission consent tying arrangements, or cash-for carriage arrangements, have directly led to rate increases for basic or expanded basic service and decreased operating margins for basic or expanded basic service.[397] RTCs comment that some retransmission consent agreements contain nondisclosure provisions prohibiting cable operators from informing their customers that rate increase may be attributable to increased retransmission consent fees.[398]

Smaller cable operators specifically complain about the Commission's network nonduplication and syndicated exclusivity requirements. ACA states that the exclusivity rules, combined with retransmission consent, entitle a broadcast group to withhold, or threaten to withhold, a local network signal from a cable operator and prevent that cable operator from bringing in a substitute network signal. According to ACA, when a broadcast group demands a "price" for retransmission consent, the same company can foreclose access to lower cost alternative sources of the same programming. ACA argues that these regulations hurt competition and consumers where a media firm seeks carriage of affiliated satellite programming, cash, or other substantial consideration for retransmission consent.[399] ACA states

[393] Time Warner Cable Comments at 10-11, *citing* NCTA Comments in MB Docket No. 03-172, p. 63-64 (Sept. 11, 2003).

[394] NTCA Comments at 2; OPATSCO Comments at 3; and Rural Independent Competitive Alliance 2.

[395] *See, e.g.*, Linda Moss, *Disney's Retrans Clout Comes to SoapNet's Aid*, Multichannel News, November 1, 1999 ("The Walt Disney Company is playing hardball with some cable operators over its new SoapNet channel, telling two small systems in Illinois that they can't continue carrying the signal for ABC's Chicago TV station unless they add the soap opera network to their line-ups.").

[396] ACA Comments at 34-36; RTC Comments at 1. *See also* Pioneer Comments at 6 (noting that broadcasters have demanded reservation of considerable blocks of local cable advertising avails from the cable operator for cross-channel promotion of the broadcaster's service, or services, to be delivered at no charge, in exchange for retransmission consent of the broadcast network).

[397] ACA Comments at 34. *See* Echostar Comments at 2-3 (stating that while, at times, a firm may offer retransmission consent for its local network channels on an ostensibly stand-alone basis, retransmission consent may be offered at a price that is much higher than the rate for comparable local network stations. In such circumstance, accepting the bundle is the only real economically feasible alternative if the distributor is to be able to provide the local network station to its subscribers at a reasonable price).

[398] RTC Comments at 10-11.

[399] ACA Comments at 21-22. *See also* Pioneer Comments at 6-7 (asserting that network affiliated television stations in the Wichita-Hutchinson-Plus DMA have used their non-duplication rights to block the carriage of adjacent Denver market stations, even though its subscribers want those stations to be carried).

that the Commission should initiate a rulemaking to revise the market protection regulations so that when broadcasters impose a "price" on retransmission consent, cable operators and subscribers are free to obtain lower cost alternatives. Discovery echoes ACA's sentiments and states that the network non-duplication and syndicated exclusivity rules improperly enhance broadcasters' negotiating position.[400] The National Association of Broadcasters ("NAB") asserts that Congress contemplated the precise situation about which the parties' complain, and such complaints should be regarded as one seeking to overturn Congress' considered judgment in the 1992 Cable Act.[401]

E. Affiliation Agreements and Contractual Terms of Program Networks

Nondisclosure Clauses. Nondisclosure provisions preclude the parties subject to the agreement from disclosing market-sensitive rates, terms, and conditions. Many small cable operators state that the Commission should scrutinize nondisclosure requirements found in programming affiliation agreements in order to understand the harms associated with contractual bundling. According to Pioneer, non-disclosure provisions are used by programmers to shield vital rate information. Pioneer asserts that small operators are prohibited from informing their subscribers the actual reasons why rates have increased.[402]

ACA states that nondisclosure provisions are always a requirement of the programmer, not the cable operator. ACA explains that in recent negotiations, certain small operators requested removal of nondisclosure provisions. In each case, negotiators for the program networks rejected the request as "nonnegotiable." According to ACA, specific information necessary for an informed opinion on bundling is contained within specific programming contracts. ACA suggests that the Commission may obtain such information if program networks agree to waive nondisclosure provisions for the purposes of this inquiry. If there are any "takers" among the programmers, and to the extent any of the nondisclosure provisions are mutual, ACA will work to facilitate obtaining consents from the small cable sector as necessary to open those agreements for Commission and Congressional scrutiny. Even if certain programmers resist disclosure, ACA asserts that the Commission may exercise its authority under Section 403 to investigate specific terms, conditions and prices contained in programming contracts.[403] Consumers Union and local franchising authorities agree with the small cable operator groups that nondisclosure provisions prevent the government and the public from fully understanding the means by which program networks contractually force carriage of content on distributors.[404]

The Tennis Channel and other program networks assert that MVPDs also want to include confidentiality provisions in distribution agreements in order to protect their sensitive business information. These provisions are mutually beneficial for, and binding on, MVPDs and program networks alike. The confidentiality of the terms of business relationships between private parties has long been recognized to have pro-competitive benefits.[405] Tennis states that the stance taken by ACA and others would turn this principle on its head by requiring affirmative public disclosure of confidential information that normally is protected from disclosure. Tennis concludes that no one has presented

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400 Discovery Comments at 23.

401 NAB Reply Comments at 7-8.

402 Pioneer Comments at 5.

403 ACA Comments at 8-9, *citing* 47 U.S.C. § 403.

404 CU Comments at 9-10; NATOA Comments at 5.

405 Tennis Reply Comments at 11-12, *citing Carpenter v. United States*, 484 U.S. 19, 26 (1987)

evidence that would warrant such a "radical departure" from established principles of law and business practice.[406]

Volume Discounts. Program networks, like many other producers of goods and services, provide price discounts for large volume distributors in their contracts. Some MVPDs assert that program networks impose "arbitrary" volume-based discounts that serve to discriminate against smaller operators and new entrants in the MVPD marketplace. Pioneer, for example, states that volume discount clauses are designed in the favor of large operators, and of little or no benefit to small operators. According to Pioneer, many volume discounts do not begin to take effect until an operator has reached a distribution of as much as 100,000, or 250,000, or more. In the case of most small and independent operators, including Pioneer which serves less than 10,000 cable subscribers, the majority of these volume discounts are almost entirely unattainable on an individual basis.[407]

As an accommodation to smaller cable operators, Disney states that it has entered into carriage agreements for each of its programming services with the National Cable Television Cooperative ("NCTC"). Disney asserts that the NCTC deals allow small cable operators to earn volume discounts to which they would not be entitled on their own. Just recently, ESPN entered into a new carriage deal with the NCTC. According to Disney, more than 95% of the NCTC's members opted to participate in this deal (including Cable One Inc., Cebridge Connections, Buckeye CableSystem, and Massillon Cable TV). This comprehensive deal is similar to affiliation deals that ESPN struck earlier with larger operators such as Cox, Charter, and Cablevision.[408]

Pioneer notes that it often obtains programming at a better price through affiliation with the NCTC. However, it states that the membership and associated leverage of the NCTC in negotiating preferred rates and obtaining volume discounts is still appreciably less than that of the larger cable operators. Pioneer further states that there are a number of networks that have yet to make their programming available to the membership of the cooperative through master affiliation agreements with the NCTC.[409]

ACA states that programming costs for certain of its members increased up to 30%, solely because a smaller company acquired ownership. ACA remarks that while programming costs increased when cable systems transferred ownership from a large cable operator to a small cable operator, delivery costs did not change (the same headends received the same satellite signals as before) and administration costs did not change (the smaller operator continued to pay monthly programming fees through the NCTC and programmers were paid directly, and on time). ACA submits that the only discernable change was the lack of market power of the smaller cable company compared to its major MSO predecessor.[410]

Tying Arrangements and Placement Conditions. Echostar submits that the current system only promotes the carriage of groups of channels connected with large programming and distribution companies. Echostar states that of the 39 new networks created since 1992, only six have no affiliation

[406] *Id.,citing* Restatement (Third) of Unfair Competition § 39 cmt. A.

[407] Pioneer Comments at 8.

[408] Disney Comments at 36.

[409] Pioneer Comments at 8-9.

[410] ACA Comments at 39.

with an MSO or network broadcasting entity.[411] According to Echostar, this fact is merely reflective of these programming companies' "dominance" over cable programming generally, as the Commission recently determined that of the top 15 prime time cable networks in terms of ratings, all were affiliated with either an MSO or major broadcast network.[412] Pioneer states that because many MVPDs find their channel capacity contractually dedicated to large blocks of programming bundles as mandated by the larger programmers, operators have less opportunity to open up capacity to many of the smaller and independent programmers.[413]

According to the RTCs, most popular program networks currently require MVPDs to purchase their entire product line, consisting of multiple programming services (a practice known as "full line forcing") in order to purchase the one or two services that the MVPD's customers desire. The result is a situation where MVPDs must offer, and customers must purchase, increasingly "bloated" service tiers at higher prices in order to continue to receive the core services they desire to purchase. In many cases, these additional services (for which additional charges are levied on the MVPD) must also be carried on the expanded basic service tier.[414] Cablevision remarks that not every service is sufficiently popular and broad in appeal, or sufficiently cost-efficient, to warrant carriage on the expanded basic tier. Many of those with more targeted appeal, or that add significant costs to the tier rates, are better placed on a smaller tier or on their own.[415]

Program networks argue that they do not always require MVPDs to carry all affiliated programming as a condition for carrying the most popular programming services. Disney, for example, states that it permits MVPDs to license its most popular individual channels without being obligated to also license any other Disney owned service. For example, an MVPD may elect to license the Disney Channel but not license Toon Disney. Cable and satellite distributors also may enter into standalone license agreements for SOAPnet or ABC Family. A distribution license for ESPN does not obligate the cable or satellite operator to carry ESPN2, ESPN Classic or ESPNEWS.[416] Viacom also states that it does not force MVPDs to carry any of its program services, such as Nickelodeon, MTV, or Spike TV. Despite the handful of claims to the contrary, it asserts that all MVPDs are free to buy none, one, several, or all of its services.[417]

Disney takes issue with any suggestion that all of its sports program networks must be carried on the expanded basic tier. Disney states that ESPN offers the opportunity for any MVPD to carry only the ESPN service. ESPN does not require carriage of its complementary ESPN services like ESPN2 or ESPN Classic before it will negotiate for carriage of ESPN. ESPN does provide the complementary ESPN-

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[411] Echostar Reply Comments at 11.

[412] *Id., citing 2003 Video Competition Report*, 19 FCC Rcd at 1693.

[413] Pioneer Comments at 8.

[414] RTC Comments at 4.

[415] Cablevision Reply Comments at 10. Other distributors argue that the bundling of particular program types, such as sports, into the expanded basic tier is harmful to both MVPDs and their subscribers. *See* BSPA Comments at 7-8 ("A consumer that does not desire sports programming is not only forced to receive sports programming, but is required to absorb a major portion of the increase in cable rates related to sports programming.")

[416] Disney Comments at 35-36.

[417] Viacom Reply Comments at 16.

branded services only to those distributors who have licensed ESPN; however, no distributor who licenses ESPN is required to license any of the other ESPN-branded services.[418]

Market Penetration Requirements. Echostar states that many program vendors make market penetration requirements a condition of selling programming. For example, a programming vendor might offer a distributor a popular program network on the condition that the channel is placed in one of the MVPD's high penetration packages. Echostar asserts that this condition deprives the distributor of the flexibility to put the channel in a program package with a lower market penetration or place the channel in its lineup with out regard to market penetration. According to Echostar, these requirements make a la carte or tiered offerings impossible with respect to the affected networks.[419]

Disney, however, states that it offers MVPDs significant flexibility to choose the manner in which they carry its many programming services. For example, MVPDs may negotiate for carriage of ESPN2 and ESPN Classic on the first, second or third most widely-penetrated tier. Disney negotiates for carriage of ESPN, Disney Channel and ABC Family on either the first or second most widely-penetrated tier of service.[420] Finally, ESPNEWS, Toon Disney and SOAPnet are available to be carried on any tier.

Delete Rights. America Channel ("A.C.") asserts that several large cable operators are requiring independent networks to accept 30-day delete rights as part of carriage deals. Delete rights enable a cable operator to "delete" or drop the independent network and terminate all distribution -- at any time, for any reason. America Channel avers that networks owned by large media companies, and networks owned by cable operators, are not subject to delete rights, and frequently lock in distribution for periods of up to 15 years, even if ratings are abysmal or the content inappropriate.[421]

F. Recommendations for the Wholesale Market

Some of the sales methods discussed, in combination with various regulatory and technological constraints, may cause harms in the market for video programming. Further, some of these harms may carry through to the retail market and adversely affect consumers. In particular, there is some concern that non-affiliated program networks may not be able to gain widespread carriage due to the industry practice of tying carriage of popular program networks or broadcast stations with carriage of less-popular program networks. Nonetheless, the current retransmission consent process is a function of the statutory framework adopted by Congress and we cannot conclude that it is not working as intended. Further, to the extent tying arrangements for the carriage of particular programming is being used for anti-competitive ends, the antitrust laws provide an adequate remedy.

Commenters have raised several other issues regarding the contractual arrangements between MVPDs and video programmers including tier placement requirements, volume discounts, and non-disclosure clauses. These issues, however, are best left to commercial negotiations between MVPDs and program networks. They are appropriately situated to evaluate the trade-offs involved in negotiating license fees and other business arrangements. And again, antitrust law remains an option for parties harmed by anti-competitive conduct.

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[418] Disney Reply Comments at 3-4.

[419] Echostar Comments at 3.

[420] Disney Reply Comments at 3.

[421] A.C. Reply Comments at 3-4.

Economic Appendix

I. The Economics of Bundling in the MVPD and Video Programming Markets

Parties submitting comments in this inquiry have provided testimony by a large number of prominent economists and have habitually referred to the alleged economic benefits of bundling in the current circumstances. This analysis provides an overview of economic thought regarding bundling and applies it to the MVPD and video programming markets. The economics profession has identified a large number of reasons firms engage in bundling. For the present discussion, the most relevant reasons are cost savings, quality improvement, price discrimination, and entry deterrence.[1] The main body of this Report as well as the discussion of the Booz Allen financial model examines the cost savings and quality improvements that are alleged to arise from the bundling of video programming for sale to consumers. The present discussion will focus on the price discrimination and entry deterrent motives behind bundling.

A. Bundling as a Mechanism for Price Discrimination

Nobel-laureate George Stigler was the first to argue that the traditional antitrust view that bundling is an attempt to extend market power to related goods is not the only reason that firms may sell products in a bundle. In a short essay, he showed that bundling can be profitable if the individual values placed on two goods vary between consumers and are inversely correlated.[2] Under this scenario, bundling is used by firms to price discriminate and extract additional rents from consumers.

A simple example presented by Professor Steven Wildman at the Media Bureau's A La Carte Symposium illustrates the effect described by Stigler.[3] Wildman discussed the behavior of a firm offering two individuals the option of purchasing access to two program networks: TBS and ESPN. In the example, the first individual values TBS at $5.00 and the second individual values TBS at $2.00. The values of ESPN are then reversed; the first individual values ESPN at $2 and the second individual values ESPN at $5. The question presented is what method of sale will offer the firm the most revenue. If the firm chooses to sell the products separately, it could do so by pricing ESPN at $5.00 and TBS at $5.00. In this situation, the first individual, who values ESPN at $2.00 and TBS at $5.00, would purchase TBS since the value he places on TBS is not less than the price. He would not purchase ESPN since the price is greater than the value he places on the programming. The second individual in this example would purchase ESPN, since its price of $5.00 is not greater than the value she places on the network. She would not purchase TBS since it is priced at $5.00 and she only values it at $2.00. So under this form of a la carte sales, the firm would obtain revenue of $10.00.[4] Instead of pure a la carte sales, consider the revenue earned from bundling. Both individuals in the example would be willing to purchase a bundle consisting of ESPN and TBS at a price of $7.00, since the sum of each individual's value of the two

[1] *See* Barry Nalebuff, *Bundling, Tying, and Portfolio Effects: Part 1 – Conceptual Issues*, DTI Economics Paper No. 1, February 2003 (available at http://www.dti.gov.uk/economics/paper1-nalebuff-p1.pdf) (providing a comprehensive survey of the competitive analysis of bundling.).

[2] G.J. Stigler, *A Note on Block Booking*, in G. J. Stigler (ed.), The Organization of Industries. Homewood, Ill.: Irwin, (1968) at 165-170.

[3] *Media Bureau Symposium Transcript* at 174-175.

[4] An alternative set of a la carte prices (*e.g.*, $2.00 per network) would generate even lower revenues. In that situation, each individual would purchase both networks for $2.00 a piece and generate total revenues of $8.00.

networks is not less than that amount. Under this bundling scenario the firm would earn revenues of \$14.00, which are higher than the revenues earned from an a la carte sales method.[5]

This example illustrates the mechanism by which bundling is able to generate higher revenues than pure a la carte sales. Bundling works by making individuals' values more homogeneous. In the example, individuals' value for ESPN was not homogeneous; one individual valued TBS at \$5.00 and the other at \$2.00. Examining the value the two consumers place on the bundle, which would simply be the sum of the value the consumer places on each of the networks, indicates that the value of the bundle for both consumers is now \$7.00. This homogeneity allows the firm to raise price without worrying that consumers with low valuations of the good will not purchase it.

Since Stigler's contribution, there have been a large number of papers examining and refining the conditions under which the price discrimination motive for bundling is profitable. Much of the work has examined the impact of the distribution of consumer values on the profitability of bundling.[6] In the previous example, the values of the two hypothetical consumers were mirror images of each other and by offering a bundle the firm was able to make the consumers value for the bundled product perfectly homogeneous. These works have shown that even when consumer values are positively correlated, rather than negatively correlated as in the example, bundling may be profitable, though less so. One study by McAfee, McMillan, and Whinston illustrates an important result ("*McAfee Study*"). In the McAfee study, under very general conditions, mixed bundling (where networks are sold individually as well as a bundle) always yields profits at least as high as those earned by either pure a la carte or pure bundling.[7] Implicit in this result is that consumer welfare is lower with mixed bundling than with either pure a la carte or pure bundling, though total welfare, which includes both consumer welfare and firm profits, is not lower.[8]

While much of the analysis of bundling considers the case of bundling two goods for sale, Bakos and Brynjolfsson consider the case of bundles containing large numbers of goods.[9] Their results confirm many of the results in the two goods case and demonstrate the efficient way in which a firm engaged in bundling can extract additional value from consumers while at the same time expanding sales.

B. Bundling as a Mechanism to Deter or Limit Entry

[5] Even higher revenues could be earned if the firm could perfectly price discriminate by charging different prices to the two individuals. In this Report, it is assumed that firms are restricted to charging the same price to all individuals in a market.

[6] *See, e.g.*, W.J. Adams and Janet L. Yellen, *Commodity Bundling and the Burden of Monopoly*, Quarterly Journal of Economics, 90(3), August 1976, at 475-98; Richard Schmalensee, *Gaussian Demand and Commodity Bundling*, Journal of Business, 57 January 1984, at S211-S230; and Michael Salinger, *A Graphical Analysis of Bundling*, Journal of Business, 68(1), January 1995, at 85-98.

[7] R. Preston McAfee, John McMillan, and Michael Whinston, *Multiproduct Monopoly, Commodity Bundling, and Correlation of Values*, Quarterly Journal of Economics, 104(2) May 1989, at 371-383.

[8] *See, e.g.*, Michael L. Katz, *Wrong Diagnosis, Wrong Cure: An Analysis of the Claims Made by Dr. Mark Cooper in "Time to Give Consumers Real Cable Choices,* at 12 (An exhibit attached to the Reply Comments filed by Comcast Corporation).

[9] Yannis Bakos and Erik Brynjolfsson, *Bundling Information Goods: Pricing, Profits, and Efficiency*, Management Science, 45(2), December 1999, at 1613-1630.

The price discrimination motive behind bundled sales, as well as the cost savings and quality improvement motives, are directed at improving economic efficiency, though not necessarily consumer welfare. Firms may also engage in bundled sales for strategic reasons. The strategic reason considered here is that of entry deterrence. The motivation behind bundling in this instance is strategic in the sense that the behavior is intended to influence and react to the behavior of competing firms. Nalebuff examines the strategic incentives to bundle based on the ability to deter or limit entry and finds that the incentives, and loss in welfare, exceed those that are likely to occur when the motive for bundling is price discrimination.[10] Nalebuff considers the incentives of a firm that sells two goods and possesses some degree of market power in each of the goods. In this situation, the incumbent firm can easily defend its market against an entrant that can only supply a close substitute for one of the two goods. The bundling strategy of the incumbent firm limits the entrant to selling only to those consumers that have low values of the good that is only available in the incumbent's bundle. Consumers that highly value that good would, of course, purchase the bundle from the incumbent.

There are several interesting implications of Nalebuff's framework. One implication is that the incumbent can simultaneously defend against entrants selling either of the two goods. As long as none of the entrants can sell a close substitute for the entire bundle, the effect of limiting the impact of entry or deterring entry altogether will be present. The second implication is that, unlike the price discrimination motive, the entry deterrence motive is stronger when consumers' values for the two goods are positively correlated. This effect occurs because consumers that value the good that the entrant is able to provide are also likely to highly value the good that only the incumbent can provide. These consumers would then choose to purchase the bundle from the incumbent rather than the single good from the entrant. Similarly, the consumer that does not value the good that only the incumbent sells would also have a low value of the good the entrant is able to provide, since it is assumed that the values are positively correlated. This effect would limit the earnings of the entrant and make entry less likely.

C. Application to Video Programming

This section examines the motivations for bundling discussed above and evaluates them in the context of the sale of video programming. There is one critically important element of video programming that must be taken into account. Consumption of video programming is non-rivalrous. Allowing an additional person to consume the good (*i.e.*, view the programming), does not reduce the amount available for other individuals. This can be contrasted with a more traditional good, such as a cookie. If an individual consumes a cookie, there is one less cookie for someone else to consume. Because of this non-rivalrous consumption, there are no additional costs associated with providing access to more individuals. The cost structure of video programming production is one of high fixed costs and marginal costs close to zero. In other words, whether one household or millions of households view a program network, the costs of producing that program do not change.[11] Goods such as this are sometimes referred to as information goods or public goods.

This characteristic of video programming leads to an interesting divergence between economic efficiency and cost recovery. Economic efficiency is promoted when all consumers that value a good more than its marginal cost of production are able to consume the good. In the case of video

[10] *See* Barry Nalebuff, Bundling as an Entry Barrier, Quarterly Journal of Economics, 119(1), February 2004, at 159-187. *See also*, Yannis Bakos and Erik Brynjolfsson, *Bundling and Competition on the Internet*," Marketing Science, 19(1), Winter 2000, at 63-82 ("Bundling and Competition Study") (discussing the impact of bundling on the ability of firms to enter a new market).

[11] This should not be confused with the costs that may be necessary to produce quality programming to lure viewers. Those additional costs are fixed and are not influenced by the number of persons who view such programming.

programming, this implies that every consumer that values a video program should be allowed access, since marginal cost is zero. A price of zero would be necessary to ensure that every individual that values the programming consumes it. This introduces the tension between efficiency and cost recovery. If the price must be zero, then no profit-maximizing firm would supply the product since it would be impossible to recover the fixed costs of production. A mechanism is required that can maximize the number of consumers with access to the programming while recovering the costs of production. One such mechanism is price discrimination.

The role of price discrimination in ensuring the production of programming that consumers desire can be illustrated by expanding on the simple example presented in the previous section. In that example, there were two consumers who had negatively correlated values for ESPN and TBS. The first individual valued ESPN at $2.00 and TBS at $5.00. The second individual valued ESPN at $5.00 and TBS at $2.00. It was demonstrated that a firm would earn higher revenue by selling the products in a bundle at a price of $7.00 rather than in individually for $5.00 each. Now, production costs are introduced into this example. Imagine that the fixed cost of producing ESPN is $6.00, as is the cost of producing TBS. First consider the case of pure a la carte sales. The highest price that can be charged for ESPN is $5.00 since any price higher than that will result in no sales. At a price of $5.00, only one consumer will purchase ESPN and revenue for ESPN will be $5.00. This level of revenue does not cover ESPN's production costs of $6.00, and consequently ESPN would not be produced. Instead of offering ESPN at $5.00, the firm could offer ESPN for $2.00. In that case both of the individuals would purchase the product and revenues would be $4.00. Again, ESPN would not fully recover its costs and therefore either would not be produced to begin with or would exit the market. A similar story holds for a la carte sales of TBS--there is no uniform a la carte price that would ensure production of the programming. Consideration of bundled sales leads to a different result. If the programming is sold in a bundle for a price of $7.00, both individuals will purchase the bundle and the firm will take in revenue of $14.00. This revenue is adequate to recover the cost of producing both programs, which is $12.00. It is also useful to examine the value to society, two individuals in this example, of the programming. The first individual values ESPN at $2.00 and the second individual values it at $5.00. So the total value to society of ESPN is $7.00, which is greater that the value of producing the programming at $6.00. A similar analysis holds for TBS and illustrates that society is better off due to the price discrimination offered by bundling.[12] The ability of price discrimination to enhance total welfare in a market economy is a common result when production is characterized by high fixed costs and low marginal costs. Price discrimination based on the class of customer is a common element of pricing in industries such as electricity and freight railroads.[13]

The example also shows the fallacy behind the claim that bundling forces consumers to pay for programming they do not want. Bundling forces a consumer who places a high value on a program network to pay more for it than someone who places less value on the network, but it does not force a consumer to pay more for the bundle than the value to consumer places on the programming contained in the bundle. In a free society there is no way to force a consumer to pay more for a product than the value they place on it. Consumers always have the option of declining to purchase a product. In fact, bundling brings more consumers into the market for some types of programming because it allows a consumer to

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[12] *See, e.g.*, Steven Wildman and Bruce Owen, *Program Competition, Diversity, and Multichannel Bundling in the New Video Industry*, in Video Media Competition: Regulation, Economics, and Technology, Eli M. Noam (ed.), Columbia University Press, 1985, at 244-273 (seminal paper on the benefits of price discrimination in the production of video programming); *See also* Suchan Chae, *Bundling Subscription TV Channels: A Case for Natural Bundling*, International Journal of Industrial Organization, 10(2), June 1992, at 213-230.

[13] *See* Ronald R. Braeutigam, *Optimal Policies for Natural Monopolies*, in Handbook of Industrial Organization, Vol. 2, Richard L. Schmalensee and Robert D. Willig (eds.), North-Holland, 1989, at 1289-1346.

view programming for which they have a low value and would not purchase if they were required to pay a so-called "fair share" of the production costs.

Much of the economic analysis of bundling has involved analyzing the behavior of a monopolist. Cable and satellite operators actively compete for customers. Bakos and Brynjolfsson have examined the nature of competition between firms that engage in bundling of information goods.[14] They find that a firm that bundles its products will dominate competition against a firm that sells products a la carte. On the other hand, when all competing firms offer bundles, they find that competition is more intense, and consequently prices are lower, than when all firms are selling on an a la carte basis. Finally, Bakos and Brynjolfsson find that firms that offer bundles have a greater incentive to innovate due to the increased ability to recover the costs of innovation through incorporating the innovations into existing bundles.

This analysis has discussed why the price discrimination engendered by bundling video programming for sale to consumers may have welfare-enhancing effects. This analysis has also discussed one of the strategic reasons why bundling may reduce welfare by deterring entry of competitors or inhibiting effective competition. This effect works when competitors cannot offer the full bundle of programming that incumbents can. In general, there is scant evidence of this in the MVPD industry. Commission regulations prohibit a number of practices that could lead to this problem. Broadcasters have an affirmative duty under the Communications Act to negotiate retransmission consent in good faith with MVPDs.[15] This obligation includes a number of per se requirements, including, *inter alia*, the obligation to negotiate retransmission consent with all MVPDs, the obligation to refrain from take-it-or-leave it negotiation, and the obligation to not unduly delay retransmission consent negotiations.[16] MVPDs are generally prohibited from demanding exclusive programming agreements from video programmers,[17] though there are examples of MVPDs that do have exclusive agreements for content.[18] Video programmers that are integrated with MVPDs are forbidden from unreasonably discriminating against other MVPDs when offering satellite-delivered video programming for sale.[19]

Thus, the bundling of video programming for sale to consumers is likely a welfare-enhancing activity, after accounting for the cost savings and quality improvements, as well as the positive impacts to promote the production of valuable programming.

Bundling also exists in the wholesale market for video programming. Some MVPDs have commented on how video programming producers require MVPDs to purchase program networks as a bundle rather than as individual networks. Price discrimination in the wholesale market would allow program networks to cover their fixed production costs just as in the retail market. However, unlike bundling in the retail market, bundling is not the only price discrimination mechanism feasible in the wholesale market. The wholesale market is characterized by one-on-one negotiations between video

[14] *See Bundling and Competition Study*, at 63-82.

[15] *See* 47 U.S.C. § 325(b)(3)(C)(ii).

[16] *See* 47 C.F.R. § 76.65(b).

[17] *See* 47 U.S.C. § 548(c)(2)(D).

[18] For example, DirecTV has an exclusive contract for NFL Sunday Ticket.

[19] Some video programming that is not delivered to MVPDs via satellite is not offered to new entrants. For example, Comcast's terrestrially delivered regional sports network, SportsNet Philadelphia, is not made available to competitors' DirecTV and EchoStar.

programmers and MVPDs. In this setting there are ample opportunities to tailor rates to the competitive market conditions and ensure that those that place a high value on the programming pay a large share of the production costs.[20] Unlike the retail market, the entry deterring effects of bundling or tying arrangements at the wholesale level are of some concern. Program networks, because they are differentiated products lacking perfect substitutes, possess varying degrees of market power. Under these conditions, Nalebuff's results indicate that entry by a firm able to supply only a portion of the goods in the incumbent's bundle is unlikely to be successful, even when the entrant is able to produce a higher quality product.

[20] The Commission's good faith retransmission consent rules, as well as the program access rules, allow prices for programming in the wholesale market to vary based on market conditions.

II. Analysis of Booz Allen Hamilton Economic Study

Booz Allen Hamilton ("Booz Allen") has produced a study modeling the likely outcomes if a la carte sales to consumers were introduced in some form.[1] The three methods of sale considered are: (1) pure a la carte where channels are only sold on an individual basis; (2) mixed bundling where channels are offered in tiers, as they are today, as well as on an individual stand-alone basis; and (3) themed-tiers where program packages with fewer channels in them are offered to consumers.

A. An Overview of the Financial Model.

The financial model begins by forecasting overall consumer response to the availability of a la carte or themed tier offerings and the consumer response to various types of program networks. With these projections, the impact on program networks and cable operators can be estimated. Much of the impact on program networks will vary depending on consumer responses since the main revenue generators for a program network are subscription fees and advertising, both of which depend on the number of households subscribing to and viewing a network. In addition, there will be an impact on the expenses program networks incur to market their programming. In response to these changes, program networks are modeled to either increase affiliate fees or reduce programming expenses to maintain operating margins. Depending upon the network characteristics, consumer responses, and the regulatory environment, per subscriber affiliate fees are forecast to rise by 38% to 2392%. In addition to the increased affiliation fees, which are assumed to be passed through to subscribers, cable operators will see a number of areas where costs will increase, as well as areas of savings under some methods of sale. Cable operators are projected to see cost increases in areas such as customer service and equipment costs. Advertising revenues earned by cable operators are also projected to fall, as are revenues from ancillary video and other uses of bandwidth in some scenarios. The impact on cable operator costs, net of the increases in network affiliate fees, ranges from increases of 17% to 56%. Assuming that consumers make up for the increased costs and reduced advertising revenues through the rates they pay, the model predicts that cable rates will rise between 4.5% and 30.3% depending on the tiers or channels chosen by the consumer and whether program networks increase affiliate fees or reduce programming expenses in the new environment. In the pure a la carte environment, the average channel is projected to cost between $4 and $5 per month.

B. Estimating Consumer Responses to Alternative Methods of Sale

Program networks are highly differentiated products and consumers do not view one network as a perfect substitute for a different network. Consequently, consumer responses to alternative methods of sale such as a la carte will vary from network to network. Booz Allen categorized networks into 6 segments based on an analysis of their characteristics; general entertainment and sports networks, news networks, older-skewing networks, younger-skewing networks, emerging mass market networks, and emerging niche networks.[2] For each of these segments, a maximum proportion of consumers that would take a network in the segment if the channel were available on a stand-alone basis is analyzed. These values ranged from 10% for the emerging niche and mass market networks to 30% for the general entertainment and sports networks.[3] Forecasting the take rates of the mixed bundling and themed-tier

[1] *See* Booz Allen Hamilton, *The A La Carte Paradox: Higher Consumer Costs and Reduced Programming Diversity* (July 2004) (Attached as Attachment A to Comments filed by NCTA) ("Booz Allen Study").

[2] *See Booz Allen Study*, Figure 10.

[3] *Id.*, Figure 14.

environments involved estimates of the likelihood of consumers switching from their current tiers to either a la carte or themed tiers. Booz Allen pegged this value at 50% for both sales methods. One additional step was required for analyzing the impact on the individual network segments in the themed-tiers environment. Several illustrative tiers such as family-friendly and sports tiers were developed. Each tier would contain a mixture of networks from each of the segments. Based on these illustrative tiers, average take rates for networks in the various network segments are estimated to range from 14% for emerging niche networks to 42% for general entertainment and sports networks.[4]

C. The Effects on Program Networks

Advertising Revenue. Advertising accounts for 35% to 52% of the revenues in the network segments examined in the studies.[5] Under the alternative sales methods examined by Booz Allen, the number for subscribers is forecast to drop and consequently viewership will drop as well. However, the extent to which viewership will drop is dependent on the viewing habits of those people who continue to subscribe to a program network under the alternative methods of sale and those who do not. The Booz Allen study assumes that heavy viewers of a network are somewhat more likely to continue purchasing a network and that those households that do purchase a network are likely to watch it more than they do currently since they are likely to have access to fewer channels. Therefore, audience ratings decrease less than subscribership does. Under the pure a la carte environment, the projected range of viewership decline is from 12% in the news network segment to 56% in the emerging mass market segment.[6] Under the mixed bundling and themed-tiers environment, the declines range from 8% in the news network segment to 29% in the emerging mass market segment.[7] The final step in determining the likely impact on advertising revenues is to understand the relationship of advertising rates to subscribers and total viewers. Many commenters have suggested that reduced subscribership and viewership reduces the price advertising agencies are willing to pay for advertising that reaches a given number of viewers, the so-called cost-per-thousand ("CPM").[8] Accordingly, Booz Allen assumes a 10% decrease in the CPM for advertising in the general entertainment and sports, news, older-skewing, and younger-skewing network segments. The emerging mass market and emerging niche network segments were assumed to experience a 20% drop in CPMs due to the more substantial drops in viewership experienced by those segments.[9] Overall, under a pure a la carte requirement, the average cable network will see advertising revenues fall by 29%.[10] Under either a mixed bundling or themed-tiers framework, the average network will see a 21% decrease in advertising revenues.[11] The news network segment is projected to see the smallest advertising

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[4] *Id.* at 42. The news network segment was not assumed to be added to any themed-tiers, but remain as a part of existing channel packages.

[5] *Id.*, Figure 11.

[6] *Id.*, Figure 15.

[7] *Id.*, Figure 15.

[8] *See, e.g.* (Disney 13-14); (Viacom 19-21); (A&E 17-18); and (Discovery 9-10).

[9] At the Media Bureau Symposium, Professor David Waterman reported on his research examining the relationship between the audience of a cable network and the advertising rates it could charge. His findings were that a 10% reduction in a cable network's audience led to a 13% reduction in advertising rates. *Symposium Transcript* at 187.

[10] *Booz Allen Study* at 49.

[11] *Id.*

losses while the emerging mass market network segment is forecast to face the most significant losses in advertising.[12]

Marketing Costs. The Booz Allen study also projects that the alternative methods of sale will have an adverse impact on the costs of program networks. The study projects that in a pure a la carte environment, marketing expenditures would rise from 2%-6% of revenues to 30% of revenues for the emerging mass market and niche network segments and 25% for the remaining segments.[13] In the mixed bundling and themed-tier environments, marketing expenditures would be 25% and 20%, respectively. These increased marketing expenses are realized because networks that currently are available on tiers with large numbers of channels expend very little effort convincing consumers to subscribe to the tier. Instead, networks included in large tiers concentrate on marketing to cable operators to gain carriage and to tempt consumers to sample their programming. However, under the alternative methods of sale, channels are projected to significantly raise their marketing efforts since they will need to inform consumers about their product to gain subscribers.[14] The values that are used, 20%-30% of revenues spent on marketing, are chosen based on marketing expenditures in other industries and on cable networks that are currently sold on an a la carte basis.[15] Consumers Union and Consumer Federation of America argue that a more appropriate value in the mixed bundling scenario would be an expenditure of 12% to 16% of revenues, rather than the 20% to 25% of revenues assumed in the Booz Allen study.[16] While marketing responses of programmers are likely to vary, reliance on the decisions of successful a la carte networks provides the most reasonable estimate of behavior under an a la carte or themed-tier regime.

Affiliate Fees. As previously discussed, the number of subscribers, and consequently the affiliate fees they generate will fall under all three alternative methods of sale. The percent of subscribers ranged from 10% for the emerging niche and mass market networks to 30% for the general entertainment and sports networks in the a la carte environment and from 14% for emerging niche networks to 42% for general entertainment and sports networks in the mixed bundling and themed-tiers environment.[17] Given these economics, a program network introduced into an environment with these alternative methods of sale faces two choices to maintain its cash flow: (1) increase revenue or (2) reduce expenses.[18] Booz Allen examines the likely impact when the program network increases affiliation fees or reduces programming expenses. To maintain current cash flow in a pure a la carte environment, all of the networks in the study's segments would have to raise their affiliation fees by at least 400% and ranging

[12] *Id.* at 43-48.

[13] *Id.* at 42.

[14] Among the marketing activities that an a la carte channel must engage in are combinations of corporate marketing in conjunction with various MVPDs, cross-promotion on the distributor's other services, mass media advertising, direct mail, telemarketing, bill-stuffers, internet promotions, and incentive programs for the MVPD's customer service representatives. Starz Comments at 4.

[15] *Booz Allen Study* at 27-28. However, Disney notes that when the Disney Channel was sold on an a la carte basis, it spent 10% of its revenue on telemarketing, subscriber acquisition programs, and retention programs. Disney Comments at 21. Disney also reports that it considers its experiment with a la carte sales of the Disney Channel to be a failure.

[16] CU/CFA Reply Comments at 32.

[17] *Booz Allen Study* at 42 and Figure 14.

[18] Cash flow in this study is defined as earnings before taxes, interest, depreciation, and amortization ("EBITDA").

up to nearly 2500%.[19] In the mixed bundling and themed-tier environment, affiliation fees would need to rise by a minimum of 100%, and as high as 300%, to maintain programmers' current levels of cash flow. The emerging mass market network segment is projected to see the most significant increase in affiliation fees, while the general entertainment and sports network segment will experience the highest increases in absolute terms. Depending on the method of sale and network category, increased marketing expenses account for between 24% and 44% of the increase in affiliation fees. The remainder of the increase, between 56% and 76%, is due to the reduced number of subscribers and the resulting impact on advertising and affiliate revenues.

The underlying assumption of these calculations is that program networks price their product to retain their cash flow margins.[20] Consumers Union and Consumer Federation of America argue that a form of a la carte will force networks to reduce their cash flow margins and accept lower levels of profits.[21] Scant evidence is offered in support of this proposition. In a world where a cable operator's savings in programming expense can be directly converted into profits, it is difficult to imagine a mechanism that would generate CU's outcome. Furthermore, in a market characterized by differentiated products where demand responses are muted due to the absence of close substitutes, the Booz Allen assumption may be closer to the likely outcome. However it is also instructive to examine outcomes if demand were more responsive, thereby forcing operating margins down to more competitive levels. The Bureau staff has performed an analysis using the Booz Allen model whereby cash flow is limited to be 10% of revenue. Such an analysis indicates that if cash flow margins were constrained by competition to be 10%, affiliate fees under a pure a la carte scenario would still rise, by a minimum of 260%. In the themed-tier and mixed bundling environments, affiliate fees would rise by between 9% and 223% depending on the network segment and the method of sale. With the exception of the younger-skewing network segment under the mixed bundling and themed-tiers environment, all network segments are projected to have a negative cash flow if they do not reduce expenditures or increase affiliate fees.

The alternative avenue for networks facing the reduced revenues and increased marketing expenses of alternative methods of sale is to reduce programming expenses. Under the pure a la carte model, the shortfall in cash flow exceeds the programming expenses of all of the network segments and methods of sale with the exception of general entertainment and sports network segment when those networks are offered in a mixed bundling or themed-tier scenarios. When program networks are offered in a mixed bundling or themed-tier environment, general entertainment and sports networks would need to reduce programming expenses by 75% to 81% to maintain current levels of cash flow. Due to the large size of the reductions in cash flow, Booz Allen uses a two-stage procedure to project the likely reactions of video programmers to the reduced revenues and increased expenses of the alternative methods of sale. When the program network's cash flow margin drops by more than one-third, programming expenses are reduced by 15%, or the amount necessary to maintain a cash flow margin of 10%.[22]

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[19] *Booz Allen Study* at 43-48.

[20] The cash flow margin, sometimes referred to as the operating margin, is simply cash flow expressed as a percentage of revenues. In the segments examined in the Booz Allen Study, this ranges from 18.1% to 48.6%. This is not equivalent to one of the common measures of market power in economics, the price-cost margin, which measures the amount by which price exceeds marginal cost. As discussed in Section I of this Appendix, the marginal cost of video programming is zero.

[21] CU/CFA Reply Comments at 31.

[22] *Booz Allen Study*, Figure 22.

Impact on Program Network Viability. Booz Allen argues that its model indicates that many of the networks in the emerging niche and mass market segments would fail. Failure would also occur in the other network segments as well as significant increases in affiliate fees and reductions in programming quality. In addition, it argues that additional consolidation would be required to obtain the efficiencies necessary for many of the independent networks to remain going concerns. Apparently, the proposed alternative methods of sale are likely to reduce the viability of many networks. The reactions of consumers to the increased ability to choose channels is the critical driver of many of these results. Unfortunately, there is no reliable information on the numbers of consumers that are likely to purchase networks or themed-tiers. Absent that information, it is difficult to generate results with much confidence. The reactions of Canadian cable subscribers to the forms of a la carte available there are unlikely to be helpful. As discussed in the Report, the Canadian system provides a large basic package that must be purchased prior to having any a la carte choices. Many of the a la carte choices of programming originating in the U.S. have Canadian produced alternatives available in the basic tier. One alternative may be to consider the channels that consumers currently watch today. Advertisers follow a measure known as the cume, which measures the number of unique viewers a network has during a given period of time. Since under current sales methods consumers incur no cost watching any specific channel included in the expanded basic tier, this may provide some information on the number of consumers that place positive value on receiving a network.[23] At the Media Bureau's Symposium, Jon Mandel of MediaCom, a leading media purchasing firm, presented figures on the weekly cume for 62 cable networks.[24] The percent of those households with access to a cable network that actually watch the network in a given week ranges from 4% to 47%, with an average of 22%. Networks that would be likely to fall into the sports and general entertainment genre, such as TNT, USA, and TBS, fall at the upper range. This analysis seems to indicate that if the most likely purchasers of a network are those that watch it at least once a week, the Booz Allen projections for take rates are reasonable after factoring in that channels will go from having no cost to view to some positive price in the pure a la carte environment.

D. The Effects on Cable Operators

The proposed alternative methods of sale will have a number of impacts on the costs and revenues of cable operators. While Booz Allen assumes that the number of cable subscribers will not change, the nature of what they choose to purchase and watch will. Some of these impacts, such as advertising, mirror those seen for program networks. Many are unique to the cable operator or satellite carrier, including increased customer care expenses, equipment costs, and use of the limited bandwidth available on cable plant.

Advertising Sales. Many program networks make a portion of their advertising time available for sale by the local cable operator to local advertisers. According to Booz Allen, the average cable operator generates $5.20 per subscriber per month from these sales, accounting for about 8% of the operator's revenue.[25] Under the three alternative methods of sale, the total amount of cable viewing is projected to fall as consumer purchase fewer channels and shift some of their viewing to broadcast networks, on which cable operators are unable to sell advertising. They project a drop of 23% under a pure a la carte

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[23] However, this analysis must be cautiously interpreted since in an expanded basic package the price of all channels is the same. This would be unlikely under an a la carte scenario. Therefore, some consumers may substitute less expensive networks for those that they prefer but happen to be more expensive.

[24] Jon Mandel Presentation at 23.

[25] *Booz Allen Study* at 52.

environment and 13% under the mixed bundling and themed-tier environments.[26] This compares to decreases of 29% and 21% for the average program network.[27]

Customer Service Costs. Under the alternative methods of sale, customer service costs are expected to increase for a number of reasons related to the expanded set of options available to consumers. Some firms will require new and expanded billing systems to accommodate the tremendous expansion in possible number of services that would be purchased in a pure a la carte or mixed bundling environment. Furthermore, additional staff at customer service centers would be required to explain the choices and handle what are likely to be more frequent changes in service. Customer service costs for the average cable operator are $3.25 per subscriber per month according to Booz Allen.[28] They predict that these costs will rise to $5.75 under a pure a la carte environment and $5.25 under a mixed bundling and themed tier environment.[29] This is contrasted to the customer care costs in the wireless industry which currently stand at $5.75. Consumers Union and Consumer Federation of America argue that the increase of customer service costs under the mixed bundling scenario is excessive when only 50% of subscribers are projected to purchase channels on an a la carte basis.[30] Absent any information of the mix of costs for the relevant customer service expenses, it is difficult to adequately examine this issue. Some customer service costs, such as changes to service, are likely to be largely proportional to the number of customers choosing to purchase channels on an a la carte basis. Other customer service costs may not be proportional. For example costs of upgrading and maintaining a billing system capable of handling a la carte sales are likely to be unaffected by the number of customers that ultimately choose to purchase channels on an a la carte basis. Similarly, the additional customer service staff and training to explain the increasingly complex array of choices available to customers would not be wholly dependent on the number of customers that ultimately chose to avail themselves of the additional product choice.

Equipment Costs. To implement the alternative sales methods envisioned, a method of ensuring that customers receive the channels they pay for, and do not receive those for which they do not pay, is necessary. A number of methods are currently used in the industry depending on whether the channels are transmitted in an analog format or in a digitally compressed format. The mix of these two types of transmission methods will vary by cable operator. Most cable operators transmit the basic and expanded basic packages in analog. This allows consumers to forgo cable set-top boxes and instead use cable-ready television sets to view programming. Some channels, notably premium channels such as Starz!, HBO, and Showtime, are also transmitted in an analog format, but are scrambled, requiring a device known as a trap, to be placed at the consumer's premise in order to allow viewing over cable-ready television sets. Channels that are transmitted digitally require either a recently introduced CableCard for digital-cable-ready television sets, a digital set-top box in order to view the programming, or some other means of converting the signal to that used by conventional television sets.[31] Under the pure a la carte scenario, Booz Allen argues that all a la carte channels must be distributed in a digital form so that either a digital set-top box or a CableCard can be used to limit access to those channels for which a consumer has

[26] *Id.* at 51.

[27] *Id.* at 49.

[28] *Id.* at 30.

[29] *Id.*

[30] CU/CFA Reply Comments at 28.

[31] This category would include interdiction devices, as those described in the Report.

purchased.[32] In the mixed bundling and themed-tier environments, Booz Allen proposes that the current basic and expanded basic tiers continue to be available as an analog feed for those consumers choosing them. In addition, duplicate digital program streams would be transmitted to control access for a la carte and themed-tier consumers. Subscribers choosing to purchase individual channels or themed-tiers, would require digital set-top boxes to descramble the signals. The purpose behind this arrangement is to reduce the number of set-top boxes that must be deployed. Booz Allen allocates $185 for each box. Of course, since cable operators typically charge a rental fee on set-top boxes, even in household subscribing to digital service, only 1.7 of the average of three television sets are equipped with boxes. Households find this a valuable trade-off since as long as the household's television sets are cable-ready, they can still receive the expanded basic tier without a box.[33] Under a pure a la carte system, Booz Allen assumes that all households would receive a digital set-top box for each of the three television sets. This would mean an increase from providing digital set-top boxes for 17% of its customers' television sets to 100% under the pure a la carte scenario. The number of additional set-top boxes to be deployed under the mixed bundling and themed-tier environments will depend on the number of consumers choosing those options. Booz Allen has assumed that 50% of customers will choose one of the options, requiring an increase of over 240% in the number of boxes deployed. Caution must be taken in evaluating the necessary deployment of set-top boxes because it is difficult to predict consumer reactions to the additional cost of such equipment. All television sets may be equipped with set top boxes if there were no added costs involved, however, when charges are introduced, subscribers may choose to purchase only the basic service tier on some sets and forgo the monthly cost of additional set-top boxes. Therefore, it is best to view these values as an upper bound. Consumers Union and Consumer Federation of America contends that the equipment cost analysis represents a "$500 solution to a $50 problem," suggesting instead that operators could use a router to service multiple sets.[34] At this time, a system such as that has not been commercially deployed. However, the situation that would be faced by cable operators undergoing the transition to digital environments is similar to that currently faced by DBS operators. In response to the substantial equipment costs involved in serving households with multiple TVs, EchoStar has introduced a digital set-top box containing two tuners capable of serving two televisions in separate rooms in the house.[35] The extent of the cost savings associated with this equipment is unclear, though it is unlikely to be a $50 solution.

Programming Costs. The likely impact of a la carte on affiliation fees that networks charge cable operators for the right to carry their programming has been extensively discussed. Under the scenario in which program networks increase their affiliate fees to maintain their current levels of cash flow, Booz Allen projects that, on average, a cable operator's total costs for programming would rise by between 50% and 65% depending on the sales method used.[36] This is less than the increase in affiliate fees imposed by program networks because, unlike today, no network will be made available to all

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[32] Booz Allen assumes that broadcast channels would remain in analog and available to all cable-ready television sets without the need for a set-top box. *Booz Allen Study* at 16-18.

[33] DBS households have 79% of their sets attached to set-top boxes versus 58% of sets in households with digital cable. The difference is likely due to the ability of digital cable households to view some analog programming while all DBS programming requires a box. *Communications Daily*, September 13, 2004 at 11 (reporting on a study by Horowitz Associates).

[34] CU/CFA Reply Comments at 27.

[35] Dish receiver Model 322 is capable of offering two standard definition television signals (http://www.dishnetwork.com/content/products/receivers/standard/index.shtml).

[36] *Booz Allen Study* at 52.

subscribers, and therefore, the cable operator would not be paying affiliate fees based on all of its customers.

Spectrum Costs. The limited bandwidth available on the cable plant has a number of valuable uses among which the operator must allocate the scarce resource. Some bandwidth is devoted to traditional linear cable channels, while bandwidth is also devoted to pay-per-view content, video on demand services, internet access, and telephony. Depending on the manner in which a la carte or themed-tiers are implemented, a cable operator may require more bandwidth for linear cable channels or may require less. Booz Allen has argued that under the pure a la carte method of sale, a cable operator would need to provide all channels in a digital form in order to control access using a digital set top box. Since all customers, or at least those choosing to purchase channels not available on the basic service tier, would require a digital box, there is no longer a need for most channels to be transmitted in analog form. This would free up additional bandwidth that could be used for other revenue-generating applications. Booz Allen estimates these savings to be about $3.75 per month per subscriber. In the case of mixed bundling and themed-tiers, Booz Allen assumes that the existing basic and expanded basic tiers will continue to be provided in analog form. Consequently, rather than freeing additional spectrum for other services, additional spectrum will be required in order to transmit individual channels in digital format and thereby control access to individual networks or tiers. Booz Allen estimates that the additional spectrum requirements of this duplication are worth $1.20 per subscriber per month in the mixed bundling environment and $0.88 in the themed-tier environment.

Impact on Cable Operator Costs. Overall, if program networks respond to the new sales environment by raising affiliate fees, cable operators are expected to see their costs increase by between 37% and 57%. Between 46% and 53% of the increase in cable operator costs is due to the increase in affiliate fees projected by Booz Allen. Set-top boxes contribute 33% to 43% of the increased costs depending on the method of sale and the remainder of the cost increase is attributed to customer service costs. If, rather than increase affiliate fees, program networks reduce programming expenses, cable operator costs will increase by 17% to 31% depending on the method of sale. Set-top box expenses would account for 71% to 80% of the increased costs of cable operators.

E. Impact on Consumers

To evaluate the impact on consumers, the likely responses of cable operators when alternative methods of sale increase their costs needs to be understood. Booz Allen makes a number of assumptions regarding cable operator behavior in order to determine the likely impact of alternative methods of sale on consumers. The global assumption is that cable operators will price its products in order to maintain their earnings per subscriber.[37] Under this assumption, average revenue per subscriber, in other words the average consumer bill, increases by between 11% and 36%.[38] The largest increases are seen in the pure a la carte environment and the smallest increases in the mixed bundling and themed-tier environment.

F. Application to DBS

The Booz Allen study examined the impact on cable operators, but much of the information can be used in examining the likely impact on DBS operators as well. For example, the impacts on customer care costs are likely to be similar for both satellite and cable operators, as are increases in programming

[37] Booz Allen measures earnings as EBITDA. Operating margins (EBITDA as a percent of revenues), however, will decline from the current 36% to between 26% and 32%. *Booz Allen Study* at 52.

[38] *Id.*

costs. What is likely to be different is the equipment costs. Programming transmitted by DBS operators is in a digitally compressed form and, therefore, a set-top box is required. A reasonable assumption would be that DBS operators would not need to supply any additional set-top boxes. If the absolute increase in per subscriber costs for programming and customer care is the same for DBS operators as cable operators, DBS average revenue per subscriber would need to rise by between 15% and 23% when programmers respond to the alternative sales methods by increasing affiliation fees and DBS operators pass those increased costs on to their customers. This amounts to rate increases in the range of $10 to $13 per month.[39]

[39] Average revenue per subscriber per month in the second quarter of 2004 was $55.59 and $65.00 for EchoStar and DirecTV, respectively. *See EchoStar Communications Corporation 10-Q*, (filed Aug. 9, 2004) at 23 and *The DirecTV Group, Inc. 10-Q*, (filed Aug. 10, 2004) at 41.

GENERAL APPENDICES

APPENDIX A: Letters From Congress

MB 04-207

May-18-04 07:13pm From- [redacted] T-983 P 002/005 F-388

W J "BILLY" TAUZIN LOUISIANA
RALPH M HALL TEXAS
MICHAEL BILIRAKIS, FLORIDA
FRED UPTON MICHIGAN
CLIFF STEARNS FLORIDA
PAUL E GILLMOR OHIO
JAMES C. GREENWOOD, PENNSYLVANIA
CHRISTOPHER COX, CALIFORNIA
NATHAN DEAL, GEORGIA
RICHARD BURR NORTH CAROLINA
ED WHITFIELD KENTUCKY
CHARLIE NORWOOD, GEORGIA
BARBARA CUBIN WYOMING
JOHN SHIMKUS ILLINOIS
HEATHER WILSON NEW MEXICO
JOHN B SHADEGG ARIZONA
CHARLES W "CHIP" PICKERING, MISSISSIPPI
VITO FOSSELLA NEW YORK
STEVE BUYER INDIANA
GEORGE RADANOVICH CALIFORNIA
CHARLES F BASS NEW HAMPSHIRE
JOSEPH R PITTS PENNSYLVANIA
MARY BONO CALIFORNIA
GREG WALDEN, OREGON
LEE TERRY NEBRASKA
MIKE FERGUSON NEW JERSEY
MIKE ROGERS MICHIGAN
DARRELL E ISSA CALIFORNIA
C.L. "BUTCH" OTTER IDAHO
JOHN SULLIVAN OKLAHOMA

BUD ALBRIGHT STAFF DIRECTOR

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ONE HUNDRED EIGHTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515–6115

JOE BARTON, TEXAS
CHAIRMAN

19 MAY 2004 RCVD

JOHN D DINGELL, MICHIGAN
HENRY A WAXMAN, CALIFORNIA
EDWARD J MARKEY, MASSACHUSETTS
RICK BOUCHER VIRGINIA
EDOLPHUS TOWNS NEW YORK
FRANK PALLONE JR., NEW JERSEY
SHERROD BROWN OHIO
BART GORDON, TENNESSEE
PETER DEUTSCH, FLORIDA
BOBBY L RUSH ILLINOIS
ANNA G ESHOO, CALIFORNIA
BART STUPAK MICHIGAN
ELIOT L ENGEL NEW YORK
ALBERT R WYNN MARYLAND
GENE GREEN TEXAS
KAREN McCARTHY, MISSOURI
TED STRICKLAND OHIO
DIANA DeGETTE, COLORADO
LOIS CAPPS CALIFORNIA
MICHAEL F DOYLE PENNSYLVANIA
CHRISTOPHER JOHN LOUISIANA
TOM ALLEN, MAINE
JIM DAVIS FLORIDA
JAN SCHAKOWSKY ILLINOIS
HILDA L SOLIS CALIFORNIA
CHARLES A GONZALEZ, TEXAS

May 18, 2004

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MAY 2 1 2004

Federal Communications Commission
Office of the Secretary

MB Report to Congress
programming
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The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C 20554

Dear Chairman Powell.

In the context of our recent examination of satellite television reauthorization legislation, the Committee on Energy and Commerce has been engaged in discussions concerning the efficacy of providing *a la carte* and themed-tier services to cable and satellite subscribers. As the members of the Committee have discussed these issues, some have indicated that they do not have sufficient information to make an informed decision on the potential merits and drawbacks of proposals which would allow multi-channel video programming distributors (MVPDs) to offer programming to their consumers on an *a la carte* or themed-tier basis.

Therefore, Committee members desire insight from the Federal Communications Commission (the Commission) to assist them in forming their judgments about these issues. Accordingly, we request that the Commission submit a report to this Committee by November 18, 2004 that answers questions relating to the ability of MVPDs to voluntarily provide their customers programming on an *a la carte* or themed-tier basis, in addition to broadcast basic and expanded basic tiers that may already be sold. The report should address, at a minimum, the following.

HISTORICAL

Do MVPDs currently have the option to purchase channels from programmers on a stand-alone basis, such that they could, if they chose, offer programming to consumers on an *a la carte* or themed-tier basis? What are the limitations, if any, on their flexibility to do so? What statutory or regulatory action would be needed to remove any such limitations?

RATES

What would the impact be on retail rates to consumers if programmers were required to offer their programming to MVPDs exclusively on a stand-alone basis, and could not also offer programming on a bundled basis for free or at a discounted rate?

What would the impact be on retail rates to consumers if programmers, in addition to the currently offered packages, were required to allow MVPDs to offer their programming on an *a la carte* or themed-tier basis if the MVPD chose to do so?

Can MVPDs currently offer *a la carte* and themed-tier service in addition to the packages currently offered, such as basic and expanded basic? Can the same universe of channels be offered both on a basic/expanded basic basis, as well as an *a la carte* or themed-tier basis? How would an *a la carte* or theme-tiered approach affect a network's ability to attract advertising revenue? Would the impact change depending upon whether an MVPD subscriber had to purchase a basic/expanded basic tier before purchasing additional channels on an *a la carte basis*? How would an *a la carte* or themed-tier option, in addition to packages currently offered, affect a network's ability to attract advertising revenue?

What effect would *a la carte* or themed-tier have on a network's per-subscriber license fees?

Are there networks that have migrated from being offered on a tiered basis to an *a la carte* basis, or vice versa? What was the effect of this migration on the network's economic viability and cost to consumers?

RETRANSMISSION CONSENT

How have broadcast networks and affiliate groups used the retransmission consent process to expand carriage of affiliated programming? How has this affected rates for MVPD offerings for consumers?

Do the rules governing retransmission consent and must-carry limit consumers' ability to select their own programming? If so, how?

DIVERSITY OF PROGRAMMING

What effect, if any, would the voluntary offering of *a la carte* or themed-tier service have on the ability of independent, niche, religious, and ethnic programming to continue to be carried or launched?

RURAL AND SMALLER MARKETS

Describe the programming cost differential for the largest cable and satellite companies and the smallest independent MVPDs in smaller markets and rural areas. What is the "volume discount" to the larger companies?

What percent of total expenses do smaller MVPDs in smaller markets and rural areas attribute to programming, and how does this compare to the largest cable and satellite companies?

What would be the impact on the programming costs of smaller MVPDs if they were to purchase programming on a stand-alone basis rather than in bundles?

What would be the impact on the programming costs of smaller MVPDs if they were allowed to offer *a la carte* or themed-tier service in addition to bundled packages?

SET-TOP BOXES

Is an addressable converter box required for every television set on which a consumer might wish to view programming offered on an *a la carte* or themed-tier basis? What is the number of television sets that are not currently connected to addressable converter boxes? What are the costs to consumers of buying or leasing these boxes?

Is an addressable converter box required for every television set on which a consumer might wish to view digital programming? Is it true that a la carte or themed-tier services can only be offered on a digital basis? What percent of cable and satellite distributors offer digital programming to their subscribers? What percent of consumers currently subscribe to digital programming packages?

What impact would *a la carte* and themed-tier service have on the uni-directional Plug-and-Play regulations, and on the ongoing discussions regarding potential bi-directional Plug-and-Play regulations?

LEGAL AND REGULATORY QUESTIONS

Is there any reason to treat cable and satellite operators differently with regard to the *a la carte* and themed-tier service?

Would MVPDs be in compliance with the must-carry rules so long as they offered all local broadcast stations on an *a la carte* or themed-tier basis, or would the must-carry rules prohibit MVPDs from offering local broadcast stations on an *a la carte* or themed-tier basis?

What, if any, Constitutional or other legal questions are raised by programmers' ability to bundle services through retransmission consent, regional sports contracts, and national programming contracts for marquee programming?

What, if any, Constitutional or other legal questions would be raised if Congress required programmers to offer their channels to MVPDs on a stand-alone basis and prohibited them from requiring carriage of their programming on particular tiers?

What, if any, Constitutional or other legal questions would be raised if, in addition to currently offered packages, Congress required programmers to allow MVPDs to voluntarily offer their channels on an *a la carte* or themed-tier basis?

Sincerely,

Joe Barton
Chairman

John D. Dingell
Ranking Member

Fred Upton
Chairman
Subcommittee on Telecommunications
and the Internet

Edward Markey
Ranking Member
Subcommittee on Telecommunications
and the Internet

Nathan Deal

cc: Commissioner Kathleen Abernathy
Commissioner Kevin Martin
Commissioner Michael Copps
Commissioner Jonathan Adelstein

MB 04-207

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JOHN McCAIN, ARIZONA, CHAIRMAN

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JOHN E. SUNUNU, NEW HAMPSHIRE

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BYRON L. DORGAN, NORTH DAKOTA
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BILL NELSON, FLORIDA
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JEANNE BUMPUS, REPUBLICAN STAFF DIRECTOR AND GENERAL COUNSEL
KEVIN D. KAYES, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL

United States Senate

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
WASHINGTON, DC 20510-6125

20 MAY 2004 RCUD

May 19, 2004

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MAY 2 1 2004

Federal Communications Commission
Office of the Secretary

The Honorable Michael Powell
Chairman
Federal Communications Commission
445 12th St., SW
Washington, DC 20554

Dear Chairman Powell:

As you know, the Senate Committee on Commerce, Science, and Transportation has closely examined the issue of escalating cable rates in recent hearings. Cable rates have increased more than 50% since 1996 – almost three times the rate of inflation. These hearings have reinforced my concern that consumers lack options that would help them control the rising cost of cable and satellite television. When it comes to purchasing cable channels beyond the basic tier today, consumers have virtually no choice but to pay for a large package of expanded basic channels even if they watch only a couple of the channels. I am writing to ask you to explore all available options within your authority to promote à la carte cable and satellite offerings as soon as possible where such offerings would benefit consumers.

Cable executives appeared before the Commerce Committee last year and proclaimed the merits of à la carte pricing options, particularly with respect to certain expensive sports programming. Charles Dolan, the Chairman of Cablevision, testified that new digital technology gives cable operators the capability to offer consumers more nuanced choices: "...this new technology gives our customers greater choice, the power to create the menu they want on the television screens in their homes. Cablevision, as a policy, wants its customers to be able to pick and choose among its services, selecting what appeals to them, rejecting what does not, determining for themselves how much they will spend, just as they do every day in the supermarket or the shopping mall. Unfortunately, our customers' shopping carts face a littered road ahead, debris left over from our industry's long technological and legislative history. Unwanted programming is being forced into the home, particularly sports programming."

Likewise, James Robbins, President and CEO of Cox Communications, in the same hearing, stated that "if operators had the flexibility to sell these networks, sports channels or others, on an optional tier, consumers would gain a significant opportunity to manage their cable expenditures. Likewise, programmers would be motivated to keep their prices reasonable to remain on expanded basic cable lineups."

Moreover, the Committee recently heard testimony regarding the availability of à la carte pricing for digital cable consumers in Canada. I urge the Commission to probe the options available to Canadian consumers and examine why such options are not available to American consumers.

À la carte pricing would enable consumers to pay for only those channels they want to watch. It would undoubtedly benefit those consumers who watch only three or four cable channels or who may be on a limited budget. It may also have the effect of disciplining cable rates overall. Finally, it would allow parents to reject channels that they find objectionable without being required to pay for the very same programming.

The cable industry regularly touts the value its expanded basic tier delivers to consumers noting that it "costs less than taking a family of four to a movie or professional sporting event." I do not believe that the cable industry should be forced to eliminate their current pricing plans. If the expanded basic package is such a great value, then few consumers will choose an à la carte option when offered, and the cable industry's predictions about the negative effect of such options on some cable networks should prove baseless. If, on the other hand, consumers reject the expanded basic package in sizeable numbers, then it would demonstrate that today's one-size-fits-all, take-it-or-leave-it packages are not such a great value.

Notwithstanding the comments of the industry's own executives, the use of à la carte pricing in Canada, and the potential benefits to consumers, the cable industry continues to fight every effort to provide choice to consumers. Unfortunately, we will never know the true effect of an à la carte pricing option as long as the industry refuses to allow it. That is why I urge you to use any existing authority you have to promote, or to create incentives to promote, an à la carte pricing option, in conjunction with whatever tiers cable and satellite companies already offer. I believe that some cable and satellite companies may be willing to offer consumers more choice if they had the ability to do so. I urge you to explore the Commission's options for creating the right environment to allow this to happen.

Thank you for your attention to this important matter.

Sincerely,

John McCain

John McCain
Chairman

APPENDIX B: Media Bureau Public Notices

DA 04-1454
May 25, 2004

MB Docket No. 04-207

COMMENT REQUESTED ON A LA CARTE AND THEMED TIER PROGRAMMING AND PRICING OPTIONS FOR PROGRAMMING DISTRIBUTION ON CABLE TELEVISION AND DIRECT BROADCAST SATELLITE SYSTEMS

Comment Date: July 8, 2004
Reply Comment Date: July 23, 2004

Through this public notice, comment is sought on factual questions regarding the provision of *a la carte* and "themed-tier" services on cable television and direct broadcast satellite systems. The responses to the questions listed below will be used in the preparation of a Report that will address questions relating to the ability of multichannel video programming distributors ("MVPDs") to provide such services to customers on a voluntary basis.

This request for comment is intended to assist in gathering information necessary to respond to specific requests from members of Congress for a Report on these issues. *See* May 18, 2004, letter from Congressmen Barton, Dingell, Upton, Markey, and Deal of the Committee on Energy and Commerce to Chairman Powell and May 19, 2004, letter from Senator John McCain, Chairman, Committee on Commerce, Science and Transportation to Chairman Powell. [Copies included in the file of this Docket.]

The Report will address, at a minimum, the following topics:

I. HISTORICAL

Do MVPDs currently have the option to purchase channels from programmers on a stand-alone basis, such that they could, if they chose, offer programming to consumers on an *a la carte* or themed-tier basis? What are the limitations, if any, on their flexibility to do so? What statutory or regulatory action would be needed to remove any such limitations?

II. RATES

What would the impact be on retail rates to consumers if programmers were required to offer their programming to MVPDs exclusively on a stand-alone basis, and could not also offer programming on a bundled basis for free or at a discounted rate?

What would the impact be on retail rates to consumers if programmers, in addition to the currently offered packages, were required to allow MVPDs to offer their programming on an *a la carte* or themed-tier basis if the MVPD chose to do so?

Can MVPDs currently offer *a la carte* and themed-tier service in addition to the packages currently offered, such as basic and expanded basic? Can the same universe of channels be offered both on an expanded basic basis, as well as an *a la carte* or themed-tier basis? How would an *a la carte* or theme-tiered approach affect a network's ability to attract advertising revenue? Would the impact change depending upon whether an MVPD subscriber had to purchase a basic/expanded basic tier before purchasing additional channels on an *a la carte* basis? How would an *a la carte* or themed-tier option, in addition to packages currently offered, affect a network's ability to attract advertising revenue?

What effect would *a la carte* or themed-tier have on a network's per-subscriber license fees?

Are there networks that have migrated from being offered on a tiered basis to an *a la carte* basis, or vice versa? What was the effect of this migration on the network's economic viability and cost to consumers?

III. RETRANSMISSION CONSENT

How have broadcast networks and affiliate groups used the retransmission consent process to expand carriage of affiliated programming? How has this affected rates for MVPD offerings for consumers?

Do the rules governing retransmission consent and must-carry limit consumers' ability to select their own programming? If so, how?

IV. DIVERSITY OF PROGRAMMING

What effect, if any, would the voluntary offering of *a la carte* or themed-tier service have on the ability of independent, niche, religious, and ethnic programming to continue to be carried or launched?

V. RURAL AND SMALLER MARKETS

Describe the programming cost differential for the largest cable and satellite companies and the smallest independent MVPDs in smaller markets and rural areas. What is the "volume discount" to the larger companies?

What percent of total expenses do smaller MVPDs in smaller markets and rural areas attribute to programming, and how does this compare to the largest cable and satellite companies?

What would be the impact on the programming costs of smaller MVPDs if they were to purchase programming on a stand-alone basis rather than in bundles?

What would be the impact on the programming costs of smaller MVPDs if they were allowed to offer *a la carte* or themed-tier service in addition to bundled packages?

VI. SET-TOP BOXES

Is an addressable converter box required for every television set on which a consumer might wish to view programming offered on an *a la carte* or themed-tier basis? What is the number of television sets that are not currently connected to addressable converter boxes? What are the costs to consumers of buying or leasing these boxes?

Is an addressable converter box required for every television set: on which a consumer might wish to view digital programming? Is it true that *a la carte* or themed-tier services can only be offered on a digital basis? What percent of cable and satellite distributors offer digital programming to their subscribers? What percent of consumers currently subscribe to digital programming packages?

What impact would an *a la carte* and themed-tier service have on the uni-directional plug-and-play regulations, and on the ongoing discussions regarding potential bi-directional plug-and-play regulations?

VII. LEGAL AND REGULATORY QUESTIONS

Is there any reason to treat cable and satellite operators differently with regard to the *a la carte* and themed-tier service?

Would MVPDs be in compliance with the must carry rules so long as they offered all local broadcast stations on an *a la carte* or themed-tier basis, or would the must-carry rules prohibit MVPDs from offering local broadcast stations on an *a la carte* or themed-tier basis?

What, if any, Constitutional or other legal questions are raised by programmers' ability to bundle services through retransmission consent, regional sports contracts, and national programming contracts for marquee programming?

What, if any, Constitutional or other legal questions would be raised if Congress required programmers to offer their channels to MVPDs on a stand-alone basis and prohibited them from requiring carriage of their programming on particular tiers?

What, if any, Constitutional or other legal questions would be raised if, in addition to currently offered packages, Congress required programmers to allow MVPDs to voluntarily offer their channels on an *a la carte* or themed-tier basis?

We seek comment on these issues and any other issues that will inform the Report on the provision of *a la carte* or themed-tier programming by MVPDs.

VIII. PROCEDURAL MATTERS

Comments should be filed on or before July 8, 2004 and reply comments should be filed by July 23, 2004. Comments and reply comments may be filed using the Commission's Electronic Filing System ("ECFS") or by filing paper copies. *See Electronic Filing of Documents in Rulemaking Proceedings*, 63 Fed. Reg 24121 (1998). All comments should reference MB Docket No. 04-207.

Comments filed through the ECFS can be sent as an electronic file via the Internet to <http://www.fcc.gov/e-file/ecfs.html>. Generally, only one copy of an electronic submission must be filed. In completing the transmittal screen, commenters should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form." Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail. The Commission's contractor, Natek, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743. U.S. Postal Service first-class mail, Express Mail, and Priority Mail should be addressed to 445 12th Street, SW, Washington, D.C. 20554. All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission. In addition parties should serve a copy of each filing via e-mail or one paper copy to Ben Golant, Suite 4A-803, Media Bureau, FCC, 445 12th St., S.W., Washington, D.C. 20554.

Comments, reply comments, and other submissions will be available for public inspection during regular business hours in the FCC Reference Center, Federal Communications Commission, 445 12th Street, S.W., CY-A257, Washington, D.C. 20554. These documents also will be available electronically from the Commission's Electronic Comment Filing System. Documents are available electronically in ASCII text, Word 97, and Adobe Acrobat. Copies of filings in this proceeding may be obtained from Qualex International, Portals II, 445 12th Street, S.W., Room, CY-B402, Washington, D.C., 20554, telephone (202) 863-2893, facsimile (202) 863-2898, or via e-mail at qualexint@aol.com. To request materials in accessible formats for people with disabilities (Braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer and Governmental Affairs Bureau at 202-418-0531 (voice), 202-418-7365 (TTY).

For further information contact Ben Golant, Media Bureau at (202) 418-7111.

By the Chief, Media Bureau

- FCC -

FOR IMMEDIATE RELEASE:
July 13, 2004

NEWS MEDIA CONTACT:
Suzon Cameron (202) 418-1916

MB Docket No. 04-207

MEDIA BUREAU ANNOUNCES
SPEAKERS FOR SYMPOSIUM ON "A LA CARTE" MVPD PRICING

Washington, D.C. - The Federal Communications Commission's Media Bureau will sponsor a symposium on Thursday, July 29, 2004, to examine the provision of a la carte programming services on cable television and direct broadcast satellite systems. The speakers will discuss legal, technical, and economic issues related to the provision of programming on a per channel basis. The speakers will specifically explore the implications of such offerings for consumer rates, program diversity, rural and small market concerns, and FCC regulation, among other subjects.

The event will be held from 9:00 a.m. to 4:30 p.m. at the Federal Communications Commission in the Commission Meeting Room at 445 12th Street, S.W., Washington, D.C. Written materials associated with the symposium will be included in MB Docket No. 04-207.

Morning Session* – *9:00 a.m.

John Freulinghausen, Vice President and Partner, Booz Allen Hamilton.

Bennett Hooks, CEO, Buford Media Group.

Gene Kimmelman, Senior Director of Public Policy and Advocacy, Consumers Union.

Geraldine Laybourne, Chairman and CEO, Oxygen Media.

Philip Lind, Vice Chairman, Rogers Communications.

Jon Mandel, Co-CEO, MediaCom US and MediaCom Latino; Chief Global Buying Officer of MediaCom Worldwide.

Michael Willner, President and CEO, Insight Communications.

Afternoon Session* – *2:30 p.m.

Erik Brynjolfsson, Professor of Management, MIT Sloan School of Management and Director of the Center for eBusiness at MIT, Cambridge, MA.

Gregory Crawford, Assistant Professor, Department of Economics, Eller College of Business and Public Administration, University of Arizona, Tucson, AZ.

David Waterman, Professor, Department of Telecommunications, Indiana University, Bloomington, IN.

Steven Wildman, Professor of Telecommunication Studies, Michigan State University and Director of The James H. and Mary B. Quello Center for Telecommunication Management & Law, Michigan State University in East Lansing, MI.

Open captioning will be provided and other reasonable accommodations for people with disabilities are available upon request. Requests should include a description of the accommodation needed, as well as contact information should additional information be required. All requests will be accepted and every effort will be made to fulfill them, although timing considerations may make that impossible in some cases. Send requests via e-mail to fcc504@fcc.gov, or call the Consumer & Governmental Affairs Bureau:

For sign language interpreters, CART, and other reasonable accommodations: 202-418-0530 (voice), 202-418-0432 (TTY).

For accessible format materials (Braille, large print, electronic files, and audio format): 202-418-0531 (voice), 202-418-7365 (TTY).

A live audiocast of the symposium will be available at the FCC's website at www.fcc.gov on a first-come, first-served basis.

Press inquiries should be directed to Suzon Cameron at 202-418-1916.

-- FCC --

APPENDIX C: List of Leading Commenters and Reply Commenters

Leading Comments in MB Docket No. 04-207

Advance-Newhouse ("Bright House Networks" or "BHN")
Alliance for Community Media ("ACM")
American Cable Association ("ACA")
Alameda Power
A&E Networks ("A&E")
America Channel
Blonder-Tongue
Bloomberg Television
Broadband Service Providers Association (Astound Broadband, Black Hills Fibercom, Everest Connections, Gemini Networks, Knology, Prairie Wave Communications; RCN Corp. Starpower Communications, LLC, Utilicom Networks LLC, and Surewest) ("BSPA")
Cato Institute
Center for Creative Voices in Media ("CCVM")
Charter Communications, Inc.
Christian Television Network ("CTN")
Comcast Corporation
Consumers Union and Consumer's Federation of America ("CU")
Courtroom Television
Cox Communications
C-Span
DirecTV
Discovery Networks
Echostar Satellite LLC
Eternal Word Television Network ("EWTN")
Faith & Family Broadcasters
Fox Cable
Goodlife TV
GSN
Hallmark
Insight
International Channel
Joint Programmers (Altitude Sports & Entertainment, Casino & Gaming Television, Comcast Sportsnet, Comcast Sportsnet Mid-Atlantic, E!, Golf Channel, G4TechTV, Inspirational Life Television, the Inspirational Network, Martial Arts Channel, Outdoor Life Network, SiTV, Style Network, The Tennis Channel, and Wisdom Television)
LaTV
LeSea Broadcasting
Lifetime
MBC Gospel Network
Motion Picture Association of America ("MPAA")
National Ass'n of Public Affairs Networks
National Association of Telecommunications Officers and Advisors ("NATOA")
National Cable and Telecommunications Association ("NCTA")
National Telecommunications Cooperative Association (NTCA")
NBC-Universal
New Jersey Board of Public Utilities
New Jersey Division of the Ratepayer Advocate
Oxygen Media

Parents Television Council ("PTC")
Paxson Communications Corporation
Pioneer Telephone & Cable
Progress and Freedom Foundation ("P&FF')
Public Cable Television Authority
Religious Voices in Broadcasting
Rural Telephone Companies (CT Communications Network, Inc., Chesnee Communications, Inc., Cim Tel Cable, LLC, Citizens Cable Communications, Inc., Kaplan Telephone Company, Kalona Cooperative Telephone Company, Inc., Lexcom Cable, Paul Bunyan Rural Telephone Company, Sierra Telephone Company, Silver Star Telephone Company, Warwick Valley Telephone Company, XIT Rural Telephone Company) ("RTCs")
Seattle, Washington
Scripps Networks (HGTV, Food)
Small Business Advocates
Smaller Operators (Bend Cable, Bresnan Communications, Eagle Communications, First Commonwealth Cablevision, Midcontinent Communications, Millenium Digital Media Systems, LLC, Sjoberg's Inc., and Susquehanna Communications)
Sports Leagues (MLB, NFL, NHL, NBA, NCAA, PGA, WNBA)
Starz
TelAlaska
Time Warner Cable
Turner Broadcasting System, Inc.
TV One
Univision
Viacom
Walt Disney
Weather Channel

Leading Reply Comments in MB Docket No. 04-207

Allbritton Communications
Altitude Sports and the Tennis Channel
America Channel
Americans For Tax Reform, Media Freedom Project, and Frontiers of Freedom
A&E Networks
Broadband Service Providers Association
Cablevision Systems Corp.
Comcast Corporation
Consumers Union/Consumer Federation of America
Courtroom Television
Echostar Satellite, LLC
GSN
Hallmark Channel
MBC Gospel Network
Morality in Media ("MIM")
NAACP et. al.
National Association of Broadcasters ("NAB")
National Association of Telecommunications Officers and Advisors
National Cable and Telecommunications Association
National Religious Broadcasters Association
New Jersey Division of the Ratepayer Advocate
Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO")
Ovation
Oxygen Media
RCN
Rural Independent Competitive Alliance ("RICA")
Time Warner Cable
Turner Broadcasting System, Inc.
Viacom
Walt Disney

APPENDIX D: List of Economic Analyses

1. *The A La Carte Paradox: Higher Consumer Costs and Reduced Programming Diversity—An Economic Analysis of the Implication of A La Carte Pricing on Cable Customers.* Booz Allen & Hamilton (An exhibit attached to the Comments filed by **National Cable and Telecommunications Association**).

2. *Slicing and Dicing: A Realistic Examination of Regulating Cable Programming Tier Structures.* Michael L. Katz (An exhibit attached to the Comments filed by **Comcast Corporation**).

3. *Cable Program Tiering: A Decision Best and Properly Made by Cable System Operators, Not Government Regulators.* William P. Rogerson (Filed by **Cox Communications**).

4. *Regarding A La Carte Pricing.* Robert D. Willig, Jonathan M. Orszag, and Jay Ezrielev (An exhibit attached to the Comments filed by **Discovery Communications, Inc.**).

5. *Benefits of Bundling and Costs of Unbundling Cable Networks.* Michael G. Baumann and Kent W. Mikkelsen, Economists, Inc. (An exhibit attached to the Comments filed by the **Walt Disney Co.**).

6. *The Fair Market Value of Local Cable Retransmission Rights for Selected ABC Owned Stations.* Michael G. Baumann and Kent W. Mikkelsen, Economists, Inc. (An exhibit attached to the Comments filed by the **Walt Disney Co.**).

7. *Cable Networks: Bundling, Unbundling, and the Costs of Intervention.* Bruce M. Owen and John M. Gale, Economists, Inc. (An exhibit attached to the Comments filed by **Viacom**)

8. Statement of Gustavo Bamberger, Lexecon, Inc. (An exhibit attached to the Comments filed by **Fox Cable Networks**).

9. *Time To Give Consumers Real Cable Choices (After Two Decades of Anti-Consumer Bundling and Anticompetitive Gate Keeping).* Mark Cooper. (An exhibit attached to the Comments filed by **Consumers Union and Consumer Federation of America**).

10. *Wrong Diagnosis, Wrong Cure: An Analysis of the Claims Made by Dr. Mark Cooper in "Time to Give Consumers Real Cable Choices.* Michael L. Katz. (An exhibit attached to the Reply Comments filed by **Comcast Corporation**).

11. *The Economics of Cable TV Pricing: A La Carte v. All-You-Can-Eat.* Thomas Hazlett. (An exhibit attached to the Reply Comments filed by **Turner Broadcasting System**)

12. *Why a Box of Crayons Has Many Colors, and the "Cable Tax" is Not a Tax; Why Contract Confidentiality Promotes Competition; and Why the News Corp Retransmission Consent Conditions Don't Apply to Other Broadcast Networks.* Bruce M. Owen and John M. Gale. (An exhibit attached to the Reply Comments filed by **Viacom**)

APPENDIX E: A La Carte in Canada

Canada has been held out as an example of how a la carte sales in the U.S. should be organized by some commenters, such as CU/CFA. Other commenters, such as Courtroom Television, have argued that the Canadian system, in addition to being a poor regulatory model, demonstrates that few consumers actually take advantage of a la carte when it is offered.

Consumers Union and Consumer Federation of America state that while many Canadian cable operators offer programming on an a la carte basis, Vidéotron offers consumers in Quebec the kind of system that they envision for the United States. Vidéotron customers must either purchase a digital set top box for $45 after a rebate, or rent a set top box for $9 per month. In addition customers must buy basic cable that includes about 20 channels for a monthly fee of $8.25. Once this milestone has been reached, customers have a variety of choices. CU states that Vidéotron offers three additional tiers: (1) 38 channels for $20 per month; (2) 65 channels for $28; and (3) 106 channels for $40. Once one of these tiers has been chosen, Vidéotron will sell most channels to their customers individually for $1 per month, a per-channel price that drops if a consumer orders 5, 10 or 20 additional channels. Vidéotron offers 93 channels and allows consumers to select 20 or 30 of them in that bundle according to CU.[1] To offer this selection, Vidéotron duplicates the transmission of its analog channels in digital format as well. In this way, it can control access through the set top box. NCTA notes that the U.S. cable networks did not consent to carriage on Vidéotron's digital service.[2]

Philip Lind, Vice-Chairman of Rogers Communications of Canada, provided additional information on the situation in Quebec at the Media Bureau's Symposium on A La Carte Pricing.[3] He argued that the packaging choices in Quebec are due to the "English-French thing," with many of the popular English language networks offered only on a la carte and not on tiers since there is less appeal for those services in that region. The manner in which the unusual nature of Quebec has contributed to the development of video programming offerings in the Province was also mentioned by Michael Hennessy, President and CEO of the Canadian Cable Television Association in his remarks to the Washington Metropolitan Cable Club on June 29, 2004.

Cable operators in other Canadian provinces also offer forms of a la carte. Courtroom Television describes the options available for Rogers Cable subscribers. It states that Rogers subscribers who purchase a 30 channel basic tier for $24.00 and who also pay to lease a digital converter box for $8.95 can then purchase certain cable networks on an a la carte basis for $2.49 each. Alternatively, Canadian subscribers can purchase a "theme pack" containing six to ten new digital channels for $6.95 or can create their own new digital "5-pack" for $9.95, "10-pack" for $14.95, "15-pack" for $18.75 and so forth. The only channels available on an a la carte basis are the digital channels; none of the popular analog services are available on an a la carte basis. While no figures on the number of customers choosing channels on an a la carte basis is available, approximately 25% of Rogers' customers subscribe to digital cable. In fact, the pricing system and the availability of these bundled alternatives make a la carte a very unpopular option. According to a Rogers official, as quoted by Courtroom Television, "although a la carte is widely available, very few actually buy one or two channels a la carte - so few, in fact, that the company doesn't even keep track of the number." Courtroom TV does keep track of their numbers. They report that of

[1] CU Comments at 7-8.

[2] NCTA Comments at 33-34.

[3] *Symposium Transcript* at 84-85.

subscribers who receive the "Court TV Canada" service, only 0.74 percent purchase the channel on an a la carte basis.[4]

Many commenters argue that the Canadian system is different from the U.S. in a number of respects. The market for video programming in Canada is heavily regulated. The Canadian Radio-television and Telecommunications Commission ("CRTC") maintains an extensive set of carriage rules to promote Canadian culture and diversity. Among them are licensing requirements for new program networks. Program networks have been authorized in three batches; one in the late 1980's, one in 1995, and another batch in 1999. It is argued that this sequential licensing process contributed to the development of multiple tiers of service in Canada as newly licensed networks were allocated to new tiers. According to A&E, in addition to the basic licensing of program networks, the CRTC engages in basic rate regulation, the establishment of minimum wholesale rates to be paid to networks, and requiring carriage of not only broadcast stations, but also all Canadian specialty and pay television services appropriate for their markets, such as those in French.[5] These content restrictions limit the impact of the choice offered by the Vidéotron service in Quebec. Customers choosing channels on an a la carte basis must select a mix of Canadian and foreign-produced channels. They cannot choose to purchase only foreign-produced channels from Vidéotron.

The size of the Canadian market and it's relationship to the U.S., is also a factor that explains the development of a la carte in Canada. Courtroom Television states that cable service in Canada is a secondary market for many program producers, and certain services can be made available only because the larger U.S. market exists. The Canadian a la carte system exists only due to the relatively small size of the Canadian cable market (7.2 million subscribers) as compared with the U.S. cable market (65.9 million subscribers). Thus, a la carte carriage, even if widespread in Canada, would have a minimal affect on license fees and advertising revenues overall. Due to the market's relatively small size, Court TV and other U.S. cable networks devote little or no effort to market their services a la carte in Canada.[6]

Courtroom Television states that its experience in Canada further shows the limitations of a la carte options. Courtroom Television provides programming in Canada through "Court TV Canada," a channel majority owned by Chum Television and unrelated to Courtroom Television, but to which Courtroom Television licenses the right to carry its daytime programming. Since Court TV Canada is not included in the mandatory basic analog package, it can only be purchased as part of a smaller digital package or as a stand-alone service (in either case, through a digital set top box). Of those subscribers who receive the "Court TV Canada" service, only 0.74 percent avail themselves of the opportunity to purchase the channel a la carte. At this minimal purchase rate for the a la carte channel, Court TV Canada has not earned a profit. Courtroom Television states that were Courtroom Television offered solely on a strictly mandated a la carte model, there would be no prospect for continuation of the service, let alone achievement of profitability. These results confirm that even where a la carte is available, very few

[4] Courtroom Television Comments at 32.

[5] A&E Comments at 22-23. *See* Fact Sheet, Canadian Radio-Television and Telecommunications Commission, Distribution of Cable TV Services in Canada, Oct. 2, 2001, at http://www.crtc.gc.ca/ENG/INFO_SHT/CDBT4.HTM ("CRTC Fact Sheet"). In addition, the CRTC enforces "linkage rules" which are designed to ensure the maximum exposure of Canadian program networks. These rules limit the packaging and sale of programming services from the United States, such as by prohibiting a cable operator from offering a U.S.-based service on basic cable, if a comparable Canadian service already exists, and requiring any tier that includes U.S.-based cable programming also to include Canadian cable programming. *See* CRTC Fact Sheet.

[6] Courtroom Television Comments at 34.

subscribers are interested in receiving programming in this manner.[7] A&E's experience in Canada echoes this phenomenon.[8] Ken Englehart, Vice President of Regulatory Affairs for Rogers Communications, also confirms this analysis. He reports that programming services on digital cable are either re-purposing existing Canadian product or are Canadian versions of popular U.S. services that get the bulk of their programming from the U.S. and add a bit of Canadian content.[9]

In summary, the Canadian system of regulation has encouraged the development of a la carte choice. Fortunately for Canadian consumers, the larger market of the U.S., and to some extent France, have allowed programmers to remain viable by providing a source of repurposed content. Absent the ability of these larger markets to cover the substantial fixed development costs of these networks, it is unlikely that they would be able to survive. Even with this assistance, Philip Lind notes that "digital channels are experiencing economic problems, regardless of how they are packaged."[10]

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[7] *Id.* at 32.

[8] A&E Comments at 25.

[9] *Symposium Transcript* at 89.

[10] *Id.* at 84.

Appendix F: Summary of Responses to Congressional Inquiry

HISTORICAL

Do MVPDs currently have the option to purchase channels from programmers on a stand-alone basis, such that they could, if they chose, offer programming to consumers on an a la carte or themed-tier basis? What are the limitations, if any, on their flexibility to do so? What statutory or regulatory action would be needed to remove any such limitations?

MVPDs, it appears, frequently do have the theoretical option of purchasing program networks on a stand-alone basis. It is difficult to gauge, however, whether the prices offered are meaningful. Program networks are typically licensed to MVPDs with a large number of conditions governing distribution, including the tier or tiers on which the programming may be carried. Removal of these conditions would require that certain terms of existing contracts be abrogated via regulatory or statutory means. Furthermore, government action may be required to force such networks to offer these carriage options at rates consumers would view as reasonable. Section III.E of the Report provides additional information on the contractual terms contained in licensing agreements between program networks and MVPDs.

RATES

What would the impact be on retail rates to consumers if programmers were required to offer their programming to MVPDs exclusively on a stand-alone basis, and could not also offer programming on a bundled basis for free or at a discounted rate?

Notwithstanding their ability to do so from a contractual perspective, cable operators would continue to have incentives to obtain the maximum possible return at the retail level. Having a mandatory stand-alone option could, however, provide some additional leverage in negotiating programming contracts.

What would the impact be on retail rates to consumers if programmers, in addition to the currently offered packages, were required to allow MVPDs to offer their programming on an a la carte or themed-tier basis if the MVPD chose to do so?

It is estimated that offering an option to purchase program networks on an a la carte basis or in themed-tiers will lead to rate increases of at least 5%, and as high as 15%, for subscribers that continue to purchase existing packages. Sections II.F.2 and II.F.3 of the Report and Section II of the Economic Appendix elaborate on these issues.

Can MVPDs currently offer a la carte and themed-tier service in addition to the packages currently offered, such as basic and expanded basic?

MVPDs are contractually obligated to offer most program networks in their current packages and would need to renegotiate existing contracts to carry the networks on additional tiers or on an a la carte basis. From a technical standpoint, current cable infrastructure is incapable of offering extensive a la carte choices, though a limited number of themed tiers may be feasible. DBS infrastructure, due to its all-digital nature, could offer a la carte or themed tiers with limited additional expenditures on infrastructure and equipment. Any MVPD offering a la carte services, and to some extent themed tiers, would need to make substantial upgrades to customer service training and billing software. Section II.F.2 of the Report and Section II of the Economic Appendix elaborate on these issues.

Can the same universe of channels be offered both on an expanded basic basis, as well as an a la carte or themed-tier basis?

It is unlikely the same universe of channels can be offered both on an expanded basic basis and an a la carte or themed-tier basis. The financial impact of a la carte sales or themed tiers on many program networks, especially smaller networks, likely would lead to the demise of a substantial number of these entities, which will reduce the overall universe of channels. This issue is addressed in Sections II.E and II.F.3 of the Report and the Economic Appendix.

How would an a la carte or theme-tiered approach affect a network's ability to attract advertising revenue?

It is projected that a la carte or themed tiers will reduce viewership of nearly all program networks. The effect will be felt most heavily by niche networks. It is estimated that for a 10% drop in the audience of a program network, advertising rates drop by 13%, leading to an even more substantial decrease in advertising revenues. This issue is addressed in Section II.F.3.b of the Report and Section II.C of the Economic Appendix.

Would the impact change depending upon whether an MVPD subscriber had to purchase a basic/expanded basic tier before purchasing additional channels on an a la carte basis?

Requiring consumers to purchase the expanded basic tier prior to purchasing additional channels on an a la carte basis would lead to declines in advertising revenues for those networks that are not included in the mandatory packages. There would be little impact on networks included in the basic or expanded basic tiers. Some Canadian cable operators offer a la carte selections in a similar fashion. Experiences with the Canadian system are discussed in Appendix E.

How would an a la carte or themed-tier option, in addition to packages currently offered, affect a network's ability to attract advertising revenue?

It is projected that a la carte or themed tiers will reduce viewers of nearly all program networks. Thus, continuing to offer existing packages will reduce the loss in viewers, but not eliminate it. Therefore, program network advertising revenues will suffer. This issue is addressed in Section II.F.3.b of the Report and Section II.C of the Economic Appendix.

What effect would a la carte or themed-tier have on a network's per-subscriber license fees?

It is estimated that per subscriber license fees would rise by at least 400% under a pure a la carte scenario, if program networks price their product to maintain current cash flow. When program networks are offered in themed tiers or a la carte, in addition to the existing packages, per subscriber license fees are projected to rise between 100% and 300% to maintain current cash flow. If programmers reduce their programming expenditures, these increases can be limited to 75% to 80%. Section II.F.3.b of the Report and Section II.C of the Economic Appendix elaborate on these issues.

Are there networks that have migrated from being offered on a tiered basis to an a la carte basis, or vice versa? What was the effect of this migration on the network's economic viability and cost to consumers?

No evidence of networks migrating from being part of a tier to a la carte sales has been introduced in the inquiry. There are several examples of migration from a la carte sales to carriage on a tier. Among those networks are the Disney Channel and the Golf Channel. Both networks report that they have been able to improve the quality of their programming since being offered as part of a large package of networks while at the same time reducing their per subscriber license fees. The experiences of these networks are detailed in Section II.F.4.b of the Report.

RETRANSMISSION CONSENT

How have broadcast networks and affiliate groups used the retransmission consent process to expand carriage of affiliated programming? How has this affected rates for MVPD offerings for consumers?

Broadcast stations whose owners also have interests in non-broadcast program networks commonly negotiate carriage of such networks in lieu of payment for retransmission consent. However, the impact on rates is unclear. While the major broadcast networks have some of the most popular programming on television, the market price in a cash transaction for retransmission consent may not reflect the full value consumers place on the broadcast station since many consumers have the option of obtaining the programming for free over the air. In the absence of any information on cash transactions for retransmission consent, a comparison with the license fees for the additional non-broadcast program networks cannot be performed and the impact on rates is indeterminate. Sections III.C and III.D.2 discuss the effects of retransmission consent.

Do the rules governing retransmission consent and must-carry limit consumers' ability to select their own programming? If so, how?

Rules governing retransmission consent, must carry, and the basic service tier do limit the ability of consumers to select their own programming. Cable subscribers cannot refuse to receive and pay for broadcast television stations. Retransmission consent and must carry also limit, to some extent, the ability of MVPDs to carry unaffiliated program networks on the most widely distributed programming tiers. Sections III.C and III.D.2 of the Report discuss the effects of retransmission consent and other similar requirements.

DIVERSITY OF PROGRAMMING

What effect, if any, would the voluntary offering of a la carte or themed-tier service have on the ability of independent, niche, religious, and ethnic programming to continue to be carried or launched?

Program networks are nearly unanimous in their belief that mandatory a la carte and themed tiers will lead to widespread failure among existing program networks that are currently sold on a packaged basis. The ability to obtain financing to launch a new network, already a difficult task, is likely to become even more arduous as investors react to the increased risk associated with a la carte sales. Section II.F.3.b of the Report and Section II.C of the Economic Appendix address the effect of a la carte and themed-tiers on network viability.

RURAL AND SMALLER MARKETS

Describe the programming cost differential for the largest cable and satellite companies and the smallest independent MVPDs in smaller markets and rural areas. What is the "volume discount" to the larger companies?

There is a lack of detailed data on program rates due to the confidential nature of contracts between MVPDs and program networks. Some commenters claim that small cable operators pay as much as 30% more than larger cable operators for a program network. However, it appears that there is no industry standard "volume discount," instead the discount varies widely between program networks. To limit the impact of "volume discounts," small cable operators have formed a collective, the National Cable Television Cooperative ("NCTC"), to purchase programming. Section III.E of the Report examines "volume discounts" for programming.

What percent of total expenses do smaller MVPDs in smaller markets and rural areas attribute to programming, and how does this compare to the largest cable and satellite companies?

Little public information on the expenses of smaller, privately-held cable operators is available. However, one source indicates that a majority of small operators allocate between 35% and 50% of their expenses to programming. For large MVPDs, programming appears to account for approximately 40% of expenses. Some sources report that programming expenses for DBS comprise a greater share of expenses than for similarly sized cable operators. Section II.D of the Economic Appendix discusses the cost structure of cable operators.

What would be the impact on the programming costs of smaller MVPDs if they were to purchase programming on a stand-alone basis rather than in bundles?

Some program networks discount the per-subscriber fees when an MVPD agrees to carry multiple networks, so programming costs of smaller MVPDs that choose to carry only a few networks may increase. However the practice varies widely among program networks with some reporting that the license fees are the same, regardless of the number of networks that are carried. Section III.E of the Report discusses these and other issues in the wholesale programming market.

What would be the impact on the programming costs of smaller MVPDs if they were allowed to offer a la carte or themed-tier service in addition to bundled packages?

While it is estimated that program networks would need to increase their license fees by at least 75%, programming expenses of cable operators are projected to rise by only 50% since there would be fewer subscribers to the networks. Section II.D of the Economic Appendix discusses the impact of a la carte and themed-tiers on the cost structure of cable operators.

SET-TOP BOXES

Is an addressable converter box required for every television set on which a consumer might wish to view programming offered on an a la carte or themed-tier basis?

While there are several products that may replicate the features of an addressable set top box, such as digital cable-ready television sets, set top boxes are considered the most cost-effective means of controlling access to a la carte programming at this time. Depending on the channel composition and number of themed tiers, traditional analog solutions, such as traps, may be feasible. The equipment required to view programming offered on an a la carte or themed-tier basis is discussed in Sections II.F.2.a and II.F.3.a of the Report and Section II.D of the Economic Appendix.

What is the number of television sets that are not currently connected to addressable converter boxes?

In DBS households, 21% of television sets are not connected to set top boxes. In digital cable households, 42% of television sets are not connected to set top boxes. Section II.F.3.a of the Report and Section II.D of the Economic Appendix discuss existing consumer equipment.

What are the costs to consumers of buying or leasing these boxes?

According to the most recent FCC Report on cable industry prices, the average rental fee for a digital converter box was $4.87 per month.

Is an addressable converter box required for every television set on which a consumer might wish to view digital programming?

No. Television sets capable of decoding digital cable channels have recently been introduced to the marketplace. Addressable set top boxes are the only currently deployed technology for displaying digital programming on television sets without uni-directional plug and play capability. Sections II.C.3 and II.F.2.a of the Report discuss the capabilities and requirements to view digital programming.

Is it true that a la carte or themed-tier services can only be offered on a digital basis?

No. However, it is likely to be the most cost-effective means for offering a la carte and themed tiers. Section II.F.2 of the Report and Section II.D of the Economic Appendix discuss the most cost-effective means of providing a la carte or themed-tier service.

What percent of cable and satellite distributors offer digital programming to their subscribers? What percent of consumers currently subscribe to digital programming packages?

All satellite carriers have deployed digital-only systems. In excess of 90% of cable operators offer digital programming to their subscribers. While subscription to digital cable varies widely among cable operators, the industry-wide average is approximately 30%. Approximately 50% of MVPD customers subscribe to digital programming. Section II.C describes current practices in the MVPD industry.

What impact would an a la carte and themed-tier service have on the uni-directional plug-and-play regulations, and on the ongoing discussions regarding potential bi-directional plug-and-play regulations?

A la carte or themed-tier service is unlikely to have an impact on uni-directional plug-and-play regulations. However, a la carte or themed-tier service may delay implementation of bi-directional plug-and-play standards if cable operators have to devote substantial technical expertise to implementing a la carte or themed-tier requirements. Further delays would occur if implementation of a la carte spurred modifications to existing technical standards for two-way set top boxes. The Commission's "plug-and-play" regulations are discussed in Section II.C.3 of the Report.

LEGAL AND REGULATORY QUESTIONS

Is there any reason to treat cable and satellite operators differently with regard to the a la carte and themed-tier service?

Competition between cable and satellite operators is promoted when regulations, where feasible, treat operators in a similar fashion and ensure that operators can offer products that are close substitutes for each other.

Would MVPDs be in compliance with the must carry rules so long as they offered all local broadcast stations on an a la carte or themed-tier basis, or would the must-carry rules prohibit MVPDs from offering local broadcast stations on an a la carte or themed-tier basis?

Under Section 338, and the Commission's rules, a satellite carrier may offer local broadcast stations on an a la carte basis as long as the rates for individual stations are comparable. A cable operator generally cannot offer all local broadcast stations on an a la carte basis because the Act requires that broadcast stations be sold together on the basic service tier and provided to every subscriber of the cable system. Section II.D.1 of the Report discusses these requirements.

What, if any, Constitutional or other legal questions are raised by programmers' ability to bundle services through retransmission consent, regional sports contracts, and national programming contracts for marquee programming?

The bundling, or tying, of video programming by private parties at the wholesale level does not raise any constitutional issues. If the arrangements raise antitrust issues (*i.e.*, anti-competitive actions resulting in consumer harm), they are best addressed by the antitrust authorities in the courts. Section III.B.4 discusses antitrust issues in the wholesale market for programming.

What, if any, Constitutional or other legal questions would be raised if Congress required programmers to offer their channels to MVPDs on a stand-alone basis and prohibited them from requiring carriage of their programming on particular tiers? What, if any, Constitutional or other legal questions would be raised if, in addition to currently offered packages, Congress required programmers to allow MVPDs to voluntarily offer their channels on an a la carte or themed-tier basis?

Requirements governing the terms of sale of programming raise potential First Amendment and Fifth Amendment issues. Constitutional issues are discussed in Section II.F.2.d of the Report.